COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

COMMONWEALTH OF VIRGINIA, ex rel. STATE CORPORATION COMMISSION, Applicants, v. RECIPROCAL OF AMERICA, In Receivership, THE RECIPROCAL GROUP, In Receivership, Respondents. IN RE: Claims and Appeal of John Knox Walkup, Special Deputy Receiver for Doctors Insurance Reciprocal, RRG; Robert S. Brandt, Special Deputy Receiver for American National Lawyers Insurance Reciprocal, RRG; and Michael D. Pearigen, Special Deputy Receiver for The Reciprocal Alliance, RRG	)	Case No. INS-2003-00024

BRIEF IN SUPPORT OF JOINT PETITION

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COME NOW, by counsel, John Knox Walkup, Special Deputy Receiver for Doctors Insurance Reciprocal (Risk Retention Group) ("DIR"), Robert S. Brandt, Special Deputy Receiver for American National Lawyers Insurance Reciprocal (Risk Retention Group) ("ANLIR"), and Michael D. Pearigen, Special Deputy Receiver for The Reciprocal Alliance (Risk Retention Group) ("TRA") (collectively, the "Tennessee SDRs" or "SDRs" and the "Reciprocals," respectively), on their own behalf and on behalf of Paula A. Flowers, Commissioner of Commerce and Insurance for the State of Tennessee as Receiver for the three Reciprocals, pursuant to the Third Directive[1] in this proceeding of Deputy Receiver Alfred W. Gross (the "ROA/TRG Deputy Receiver"), § 38.2-200 of the Code of Virginia and 5 VAC 5-20-100(B) of the Rules of Practice and Procedure of the Commission, the due process and equal protection guarantees of the United States Constitution and the Constitution of Virginia, and the Commerce Clause of the United States Constitution, and submit their Brief in Support of Joint Petition for Expedited Review of Claims and Deputy Receiver's Determination of Appeal (together, their "Appeal").

[1] Third Directive of Deputy Receiver Adopting Receivership Appeal Procedure (effective Jan. 29, 2003), in Commonwealth v. Reciprocal of America and The Reciprocal Group, Case No. INS-2003-00024 (Va. State Corp. Comm'n 2003) (the "Third Directive" and "Commonwealth v. ROA, et al.," respectively) (Exhibit 2) ("Ex. __").

N.B.: For clarity and the convenience of the Commission, the numerical sequence of Exhibits in this Appeal coincides with those submitted as part of the Reciprocals' Notice of Appeal, Claim, Request for Immediate Stay of First Directive as to Payments to ROA Insurance Policy Claimants, and Request for Relief from Third Directive (Feb. 28, 2003) ("Notice of Appeal") (Ex. 18), and their Renewed Notice of Appeal, Renewed Claim, Renewed Request for Immediate Stay of First Directive as to Payments to ROA Insurance Policy Claimants, and Renewed Request for Relief from Third Directive (Mar. 14, 2003) ("Renewed Notice of Appeal") (Ex. 19), in Commonwealth v. ROA, et al., Case No. INS-2003-00024 (Va. State Corp. Comm'n 2003) . New Exhibits begin with Ex. 18.

INTRODUCTION

This Appeal impacts tens of thousands of individuals with professional liability insurance in Virginia and throughout the United States and interrelated receivership proceedings in Virginia and Tennessee. The Virginia proceeding involves Reciprocal of America ("ROA") and The Reciprocal Group ("TRG"). The Tennessee proceedings involve DIR, ANLIR and TRA.

This Brief in Support of Joint Petition is divided into three parts:

- Part I A contains those portions of the SDRs' Appeal for which they are requesting a temporary injunction or order to require the ROA/TRG Deputy Receiver to:
  - use certain trust funds only for the benefit of the Reciprocals' subscribers and insureds (the "Reciprocals' "insureds");
  - cease the dissipation of other assets under the control of ROA/TRG until this matter can be addressed on the merits by the Commission;
  - provide the SDRs with immediate and unfettered access to all the commingled books, records, and other information under the control of ROA/TRG so they can participate in determining which of these commingled materials are the materials of the Reciprocals; and
  - provide the SDRs with immediate and unfettered access to all current and former employees of ROA/TRG who, because the Reciprocals did not have their own employees, were responsible for the management of all the insurance business and claims administration of the Reciprocals;
- Part I B contains the merits arguments for why the Reciprocals' insureds are legally entitled to be treated in the same manner and with the same priority as ROA/TRG insureds; and

- Part II sets out the constitutional arguments supporting both the request for a temporary injunction or order and the merits argument.

The Virginia and Tennessee proceedings involves five inextricably intertwined entities – four insurers (ROA, DIR, ANLIR, and TRA) and the company that managed all aspects of the insurance business and claims administration for all four insurers, TRG. The Receivers, Deputy Receivers and Special Deputy Receivers in both sets of proceedings have statutory and court-imposed fiduciary duties to obtain and exercise control over the assets, books, records, other information, and personnel of the entities in receivership in their respective states. It is their responsibility to determine whether those entities can be rehabilitated or must be liquidated, and to pursue either rehabilitation or liquidation proceedings.

The Virginia receivership proceeding involve ROA (formerly known as The Virginia Insurance Reciprocal) and TRG (formerly known as Virginia Professional Underwriters, Inc.). ROA, which is chartered and domiciled in Virginia, provides certain direct insurance, mainly to hospitals, and also allegedly provides "reinsurance" to DIR, ANLIR, and TRA. The nature of this "reinsurance" is one of the major issues in this case. TRG is ROA's attorney-in-fact and manages all aspects of ROA's insurance business and claims management. See Ex. 20, at 1-2.[2] The Commission was appointed as Receiver in the Virginia proceeding, Insurance Commissioner

[2] See Confidential Endnotes. A number of the Exhibits to this Petition and Brief are considered "confidential" by ROA/TRG or are submitted as confidential by the three Reciprocals. Thus, all of the Exhibits have been filed with the Commission under seal. Confidential Exhibits are referenced in the text as "Ex. ___, at ___," with no other information identifying the formal title of the document, and in the footnotes to this Brief as "See Confidential Endnotes." Confidential Endnotes, which include both confidential and non-confidential references, have been submitted with the copies of this Petition and Brief filed with the Commission, and with the ROA/TRG Deputy Receiver and Special Deputy Receiver, containing the full citation for each Exhibit, including confidential Exhibits.

Alfred W. Gross was appointed as Deputy Receiver, and Melvin J. Dillon as Special Deputy Receiver.

In its receivership Application, the Commission alleged, and the Richmond Circuit Court found, that ROA and TRG were so extricably intertwined that they constituted a "single insurance business enterprise" ("ROA/TRG") and as such should be placed in joint receivership. See SCC Application, Ex. 21, ¶¶ 18-24 at 4-5; Richmond Circuit Court Order, Ex. 3, ¶ 2 at 2.[3] The Richmond Circuit Court therefore gave the Commission "exclusive title both legal and equitable" to all property, including all books, records and other information, under the control of ROA/TRG; directed the Commission "to take immediate and exclusive control" of all such property; placed all such property "in the custodia legis of the Commission;" and vested the Commission "with the authority to assume and exercise sole and exclusive in rem jurisdiction over" that property. Richmond Circuit Court Order, Ex. 3, ¶ 8 at 8-9. The Court also "enjoined and restrained" "all persons," which would include all ROA/TRG officers, directors, employees and agents, "from interfering in any manner" with property in the possession of the ROA/TRG Deputy Receiver or Special Deputy Receiver and "from interfering in any manner with the conduct of the receivership. …" Id., ¶ 12 at 10.

The Tennessee receivership proceedings involve DIR, ANLIR and TRA, which are chartered and domiciled in Tennessee but which do a significant amount of business in Virginia and insure thousands of Virginia doctors, other healthcare professionals, counselors, healthcare professional associations and facilities, and lawyers. All three of the Reciprocals had an

[3] Verified Application For Final Order Appointing Receiver And For Permanent Injunctive Relief, at 4-5 (dated Jan. 28, 2003), and Final Order Appointing Receiver For Rehabilitation or Liquidation, at 4-5 (dated Jan. 29, 2003), in Commonwealth v. ROA, et al., Case No. CH03-135 (Cir. Ct. Richmond, Va. 2003) (the "Application" or "SCC Application," and "Richmond Circuit Court Order," respectively) (Exs. 21 and 3).

exclusive management and insurance services agreement with TRG, governed by Virginia law and believed to be virtually identical to the management agreement between TRG and ROA, delegating to TRG total control over the management and operations of all their insurance business and claims administration. See Exs. 4A, 4B and 4C.[4] In the three Tennessee proceedings, the Tennessee Commissioner of Commerce and Insurance, Paula A. Flowers, was appointed as Receiver for DIR, ANLIR and TRA. She in turn has appointed the SDRs as the Special Deputy Receivers for the three entities, respectively. See Tennessee Receivership Orders, Exs. 11-13.[5] The Tennessee receivership order for each of the three receivership proceedings, among other things:

- directed the Receiver to "take possession of the assets and records" of the three Reciprocals and "administer them under the general supervision of the Court" pursuant to certain statutory powers, with title to those assets being vested in the Receiver;

- directed that the Receiver "shall have immediate access to and shall occupy and control the premises and all records, databases, and computer files used to carry out the business" of the three Reciprocals, "regardless of their location and possession;"

- ordered that "all person, firms, corporations and associations, including, but not limited to, … [the three Reciprocals and their] officers, directors, stockholders, members, subscribers, agents,

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[4] See Confidential Endnotes.

[5] Consent Order Appointing Commissioner as Receiver for Purposes of Rehabilitation; and Injunction (Jan. 31, 2003), in State of Tennessee, ex rel., Paula A. Flowers, Commissioner of Commerce and Insurance for the State of Tennessee v. Doctors Insurance Reciprocal (Risk Retention Group) (Chancery Ct., 20th Judicial Dist., Davidson Cnty, Tenn. 2003) (Ex. 11); Consent Order Appointing Commissioner as Receiver for Purposes of Rehabilitation; and Injunction (Jan. 31, 2003), in State of Tennessee, ex rel., Paula A. Flowers, Commissioner of Commerce and Insurance for the State of Tennessee v. American National Lawyers Insurance Reciprocal (Risk Retention Group) (Chancery Ct., 20th Judicial Dist., Davidson Cnty, Tenn. 2003) (Ex. 12); and Consent Order Appointing Commissioner as Receiver for Purposes of Rehabilitation; and Injunction (Jan. 31, 2003), in State of Tennessee, ex rel., Paula A. Flowers, Commissioner of Commerce and Insurance for the State of Tennessee v. The Reciprocal Alliance (Risk Retention Group) (Chancery Ct., 20th Judicial Dist., Davidson Cnty, Tenn. 2003) (Ex. 13) (collectively, the "Tennessee Receivership Orders").

contractors, subcontractors and all other persons with authority over or in charge of any segment of … the affairs [of the three Reciprocals] [collectively, the "covered persons"], are prohibited and temporarily enjoined from the transaction of … [the] business [of the three Reciprocals], or the waste or disposition of its property, or the destruction, deletion, modification, or waste of its records, databases or computer files, or the commencement or prosecution of any actions, or the obtaining of preferences, judgments, attachments or other liens, or the making of any levy against ... [any of the three Reciprocals] or against ... [any of their] assets or any part thereof until further order of ... [the Tennessee] Court;

- authorized the three Reciprocals to "apply outside of Tennessee" for certain relief;

- "ordered and required" all covered persons (listed above) "to cooperate with … [the Receiver] in the carrying out of the rehabilitation. "The term 'person' shall include any person who exercises control directly or indirectly over activities of … [the three Reciprocals] through any holding company parent company, or other affiliate of … [any of the three Reciprocals]. Further, the term "person" shall include any person who exercises control or participation in the activities of … [any of the Reciprocals], such as through the record-keeping and computer systems operation relating to the activities of … [any of the Reciprocals]. "'To cooperate' shall include, but shall not be limited to, the following: (1) to reply promptly in writing to any inquiry from the Commissioner requesting such a reply; and (2) to preserve and make available to the Commissioner any and all books, bank and investment accounts, documents, or other records or information or computer programs and databases or property pertaining to … [any of the Reciprocals] and in his possession, custody or control. No person shall obstruct or interfere with the Commissioner in the conduct of this rehabilitation; …."

Tennessee Receivership Orders, Exs. 11-13, ¶¶ 1-3, 12 at 1-4, 7. These powers are virtually identical to the powers granted to the Commission and to the ROA/TRG Deputy Receiver and Special Deputy Receiver by the Richmond Circuit Court. See Richmond Circuit Court Order, Ex.3, ¶¶ 7-12 at 7-10. The Tennessee SDRs are acting on behalf of the Tennessee Receiver.

As noted above, TRG and its employees managed all aspects of the insurance business and claims administration of ROA and of all three Reciprocals. In addition, virtually all of the Reciprocals' books, records, and other information were and continue to be under the control of TRG. The interrelated relationships among TRG, ROA, and the three Reciprocals makes this case unusual. But it is the actions of the ROA/TRG Deputy Receiver and Special Deputy Receiver that have made it virtually impossible for the SDRs to perform their fiduciary duties under Tennessee law and the Tennessee Receivership Orders. And it is the denial by the ROA/TRG Deputy Receiver and Special Deputy Receiver of the SDRs' request for an expedited review of their Notice of Appeal and Renewed Notice of Appeal that has given rise to these claims and this Appeal to the Commission.

In their Notice of Appeal and Renewed Notice of Appeal to the ROA/TRG Deputy Receiver, the SDRs requested the following:

- A stay of further dissipation of all assets under the control of ROA/TRG, including actions and the payment of claims against ROA/TRG and actions by third parties against ROA/TRG insureds;
    - The ROA/TRG Deputy Receiver has refused the SDRs' request for an immediate halt to these payments;
    - Also addressed in this Appeal are certain funds held in trust or otherwise segregated and to be used only for the benefit of the Reciprocals and their insureds that recently have come to the attention of the SDRs;
- Immediate and complete access to all books, records and other information of the three Reciprocals that were or are under the control of ROA/TRG and that apparently are commingled with the books, records and other information of ROA/TRG itself;
    - The ROA/TRG Deputy Receiver has repeatedly refused to permit the three Reciprocals to participate fully in the determination of the priority in which books, records and other information are examined, and the determination of which of the materials examined are materials of the Reciprocals and which are materials of ROA/TRG;

- Although the ROA/TRG Deputy Receiver's staff has copied and sent many of the Reciprocals' books, records and other information to the SDRs, much is still missing, including critical financial data the SDRs need to determine how – or indeed, if – the Reciprocals can be rehabilitated or if, regrettably, the Reciprocals must be liquidated and their insureds, including thousands of Virginians, will have to go without coverage;

- Immediate, complete and unfettered access to all current and former personnel of ROA/TRG so they can (i) determine which personnel were responsible for activities involving the Reciprocals and then (ii) interview and otherwise communicate with those personnel;

  - The ROA/TRG Deputy Receiver has repeatedly refused the SDRs and their staffs such access, including to individuals who also are or were officers or directors of one or more of the three Reciprocals. Indeed, he has attempted to preclude ROA/TRG personnel from discussing with the SDRs and their staffs the affairs of the Reciprocals by imposing confidentiality requirements and agreements on them, including as a condition of a severance agreement for those who have been dismissed;

- Treatment of the Reciprocals' insureds and third-party claimants in the same manner and with the same priority as ROA/TRG insureds and third-party claimants – i.e., as "policyholders" or claimants against "policyholders," respectively, rather than merely as "creditors" as provided in the ROA/TRG Deputy Receiver's First Directive.

See Notice of Appeal, Ex. 18, ¶¶1-3 at 12; Renewed Notice of Appeal, Ex. 19, Parts B (1-3) at 5-10. [6]

[6] See note 1 supra.

ARGUMENT

I. THE COMMISSION SHOULD ISSUE A TEMPORARY INJUNCTION OR ORDER REGARDING THE DISSIPATION OF ASSETS UNDER THE CONTROL OF ROA/TRG AND ACCESS TO BOOKS, RECORDS, OTHER INFORMATION AND PERSONNEL UNDER THE CONTROL OF ROA/TRG.

A. THE COMMISSION SHOULD ENSURE THAT CERTAIN TRUST FUNDS ARE USED ONLY FOR THE BENEFIT OF THE RECIPROCALS' INSUREDS AND SHOULD ORDER THE ROA/TRG DEPUTY RECEIVER AND HIS STAFF TO CEASE FUTHER DISSIPATION OF OTHER ASSETS UNDER THE CONTROL OF ROA/TRG UNTIL THIS CASE IS ADDRESSED ON THE MERITS.

1. To the Extent ROA or ROA/TRG Has Agreed to Hold or Use Funds for the Benefit of Any of the Three Reciprocals or Their Insureds, the Commission Should Ensure That Those Funds Are Used Only for That Purpose.

ROA/TRG appears to take the position that it has at least two categories of assets available for its use. The first category is assets that are to be held for the benefit of the three Reciprocals and their insureds. The SDRs are particularly concerned about $57 million in trust funds that were being held for the benefit of the Reciprocals' insureds but recently were seized by the ROA/TRG Deputy Receiver. See Ex. 25.[7]

One of ROA/TRG's primary sources of reinsurance for its risk is First Virginia Reinsurance, Ltd. ("FVR"), an off-shore reinsurer located in Bermuda that is not licensed in Virginia or Tennessee and was formed by many of the same individuals who formed ROA, TRG and the three Reciprocals. See Ex. 22;[8] Ex. 20, at 3; Affidavit No. 1, ¶¶ 17-20 at 7-8; Affidavit

[7] See Letter from Curtis G. Manchester, Counsel to the Tennessee SDRs, to Patrick H. Cantilo, Counsel to the ROA/TRG Deputy Receiver, dated April 11, 2003 (Ex. 25).

[8] See Confidential Endnotes.

No.2, Aff. Ex. M.[9] The current retrocession agreement between FVR and ROA/TRG (the "FVR Retrocession Agreement") provides for a "pass through" arrangement under which ROA/TRG ceded to FVR both its risk as a first-dollar "reinsurer" of the three Reciprocals and the accompanying premiums paid by Reciprocal insureds. See Ex. 23, Arts. III, XI at 3, 6.[10] In exchange, FVR assumed that risk. Id., Art. V at 3. FVR and ROA/TRG also entered into a trust agreement (the "Trust Agreement"), effective January 1, 2002, to secure FVR's obligations to ROA under the FVR Retrocession Agreement. See Ex. 24.[11] Reading the FVR Retrocession Agreement and the Trust Agreement together, ROA/TRG may draw down these trust funds, but (absent circumstances not present here) only as needed to pay claims against the Reciprocals. Id., Sec. 1.08 at 6-7. Thus, these trust funds – currently estimated at approximately $57 million – are to be held for the benefit of the Reciprocals and their insureds and can be used by ROA/TRG only for that purpose. Id. On information and belief, until approximately April 3, 2003, these trust funds were held at least in part in a FVR trust account at Wachovia Bank in Washington, D.C. On or about April 3, 2003, however, the ROA/TRG Deputy Receiver seized the trust funds on behalf of ROA/TRG. See Ex. 25.

Another primary source of reinsurance for ROA/TRG is General Cologne Reinsurance Corporation ("Gen Re"), an international reinsurer that, based on the information available to the

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[9] See Confidential Endnotes. Affidavits in this case have been filed under seal. There are several exhibits attached to all but one of the affidavits. Thus, for the convenience of the Commission, all affidavits and their exhibits are bound separately from the Exhibits to this Brief. They are not listed as Exhibits to, but are incorporated in, this Brief. Affidavits are cited in this Brief as "Affidavit No. ___," and where the reference is to an exhibit attached to an affidavit, the citation is "Affidavit No. ___, Aff. Ex. ___." The full citation to each affidavit appears in the Confidential Endnotes the first time it is cited.

[10] See Confidential Endnotes.

[11] See Confidential Endnotes.

SDRs at this time, is not affiliated with ROA/TRG. See Ex. 22; Affidavit No. 1, ¶¶ 17-20 at 6-7; Affidavit No. 2, Aff. Ex. M. On information and belief, arrangements similar to those with FVR exist between ROA/TRG and Gen Re.

There also may be other funds that are designated or segregated and held in trust for the benefit of the three Reciprocals and their insureds. Based on the limited books, records and other information available to the SDRs at this time, however, the SDRs are aware only of the FVR trust funds and Gen Re funds. See Ex. 26;[12] Ex. 27.[13]

In order to prevent the inappropriate dissipation of the FVR trust funds, the Gen Re funds, and any other funds held for the benefit of the Reciprocals' insureds and third-party claimants under any similar "pass through" arrangement, the SDRs respectfully request that the Commission modify the ROA/TRG Deputy Receiver's First Directive[14] so that the FVR trust funds, Gen Re funds and any other funds held through a similar "pass through" arrangement for the benefit of Reciprocal insureds and third-party claimants can be used, and in fact are used, only to pay claims against the Reciprocals. See First Directive, Ex. 1.

[12] See Confidential Endnotes.

[13] See Confidential Endnotes.

[14] First Directive Continuing Insurance Policy Payments and Imposing Suspension and Moratorium on Other Claim Payments (effective Jan. 29, 2003), in Commonwealth v. ROA, et al., Case No. INS-2003-00024 (Va. State Corp. Comm'n 2003) (the "First Directive") (Ex. 1).

2. Because the Three Reciprocals Have a Reasonable Likelihood of Prevailing on the Merits of The Right of Their Insureds and Third-Party Claimants to Be Treated in the Same Manner and with the Same Priority as ROA/TRG's Insureds and Third-Party Claimants, the Commission Should Issue a Temporary Injunction Ordering the ROA/TRG Deputy Receiver and His Staff to Cease the Further Dissipation of Assets Under Their Control So This Issue Can Be Addressed on the Merits.

The second category of assets available to ROA/TRG is the remaining other assets of ROA/TRG itself, including unearned premiums collected from the Reciprocals' insureds. For the reasons set forth in Parts II and III below, the Reciprocals' insureds and third-party claimants are entitled to be treated by ROA/TRG in the same manner and with the same priority as ROA/TRG's insureds and third-party claimants. Yet, based on his First Directive, the ROA/TRG Deputy Receiver persists in his position that he may refuse to pay claims against the three Reciprocals and may treat Reciprocal insureds and third-party claimants as mere unsecured "creditors," rather than as "policyholders" and claimants against "policyholders," while continuing to use all assets under the control of ROA/TRG, including unearned premiums paid by insureds of the three Reciprocals, to pay the claims of ROA/TRG's "direct" insureds and of third-party claimants under ROA/TRG policies. See, First Directive, Ex. 1, ¶¶ 2-3 at 1-2. [15] Upon information and belief, the ROA/TRG Deputy Receiver is in fact continuing to pay these latter claims.

If it ultimately is determined on the merits that the ROA/TRG Deputy Receiver should have been treating payments to the Reciprocals' insureds and third-party claimants in the same manner and with the same priority as payments to ROA/TRG's insureds and third-party

[15] On information and belief, the ROA/TRG Deputy Receiver has not yet made an accounting of the ROA/TRG estate's payments and assets.

claimants, then these latter payments may be subject to actions for disgorgement as a preference of one set of policyholders over another.

Thus, in order to protect against this possibility and against the premature dissipation of assets, and to protect the interests of all interested parties, the SDRs respectfully request that the Commission issue a temporary injunction for 90 days, renewable at the discretion of the Commission, ordering the ROA/TRG Deputy Receiver and his staff to cease the further dissipation of any other assets under the control of ROA/TRG (which could, of course, include seeking a stay of all actions against ROA/TRG and its insureds), other than for the payment of administrative expenses, so that (i) the SDRs and the ROA/TRG Deputy Receiver, collectively, can have the opportunity, in a cooperative effort, to determine where and what the assets are and for whose benefit they are being held, and that (ii) this matter can be addressed on the merits.

3. A Constructive Trust Should Be Imposed to Prevent the Premature Dissipation of Assets and the Potential for Both Unjust Enrichment of Some Claimants and Undue and Unjust Hardship to Others.

While the above steps are necessary as to all of the assets described above, they are particularly critical with regard to the $57 million in FVR trust funds the ROA/TRG Deputy Receiver recently seized. As noted previously, these trust funds may be withdrawn by ROA/TRG but only for the payment of claims against the Reciprocals. The ROA/TRG Deputy Receiver has indicated in his First Directive, however, that he will not pay any claims of the Reciprocals until he determines that there are sufficient funds to pay claims against ROA/TRG and its insureds. First Directive, Ex. 1, ¶ 3 at 1-2. It is not clear, therefore, why the ROA/TRG Deputy Receiver seized the FVR trust funds if they are available only to pay claims he already has stated he will not pay.

Thus, in addition to a temporary injunction, as further protection against the premature dissipation of any of the assets discussed above (including the FVR trust funds and the Gen Re funds), the SDRs respectfully request that the Commission impose a constructive trust on all those assets. As the Supreme Court of Virginia instructed in Faulknier v. Shafer, 264 Va. 210, 563 S.E.2d 755 (2002):

> Constructive trusts arise, independently of the intention of the parties, by construction of law; being fastened upon the conscience of him who has the legal estate, in order to prevent what otherwise would be a fraud. They occur not only where property has been acquired by fraud or improper means, but also where it has been fairly and properly acquired, but it is contrary to the principles of equity that it should be retained, at least for the acquirer's own benefit.

Id. at 215, 563 S.E.2d at 758 (quoting Leonard v. Counts, 221 Va. 582, 589, 272 S.E.2d 190, 195 (1980) (citation omitted)). The Faulknier Court also noted the long-held principle that "[c]ourts of equity may impose constructive trusts whenever necessary to prevent a failure of justice." Id. at 215, 563 S.E.2d at 758 (quoting Richardson v. Richardson, 242 Va. 242, 245, 409 S.E.2d 148, 150 (1991) (citing Patterson's Ex'rs v. Patterson, 144 Va. 113, 123, 131 S.E. 217, 220 (1926)).

The SDRs have no assurance that the assets described above will not be prematurely dissipated. Indeed, some of those assets are being dissipated now. Thus, unless and until the commingled assets of ROA/TRG and the three Reciprocals can be thoroughly traced and accounted for, manifest injustice will be visited upon the three Reciprocals and their insureds because assets to which they have a right to access are being dissipated in favor of a select group of insureds of ROA/TRG.

A court of equity — as the Commission is in the case — has "the power in the exercise of its discretion in an ordinary case, to fashion a remedy that would eliminate or lessen the hardship

imposed upon a party by a particular decision." Frank Shop, Inc. v. Crown Cent. Petroleum Corp., 264 Va. 1, 7, 564 S.E.2d 134, 137 (2002). Here, the decision of the ROA/TRG Deputy Receiver to distribute assets inequitably in favor only of ROA/TRG's "direct" insureds imposes undue hardship and manifest injustice upon the Reciprocals and their insureds. A constructive trust therefore should be imposed by the Commission on assets under the control of ROA/TRG until such time as this matter can be more fully investigated by the SDRs and the ROA/TRG Deputy Receiver and fully addressed on the merits by the Commission.

B. THE TENNESSEE SDRs ARE ENTITLED TO IMMEDIATE ACCESS TO AND POSSESSION OF THE PROPERTY OF THEIR ESTATES, TO PRIVATE DISCUSSIONS WITH THEIR OFFICERS, DIRECTORS, AND KEY MANAGEMENT PERSONNEL AND TO COOPERATION IN THE DISCHARGE OF THEIR STATUTORY AND COURT-ORDERED FIDUCIARY DUTIES.

The ROA/TRG has refused to give the SDRs immediate, full and complete access to the Reciprocals' books, records and other information under the control of ROA/TRG, and immediate, full and complete and unfettered access to the current and former personnel of ROA/TRG who were responsible for managing all of the insurance business and claims administration of the Reciprocals. Without that access, the Reciprocals are literally withering on the vine. The SDRs are being denied the very information they need – now – to fulfill their statutory and court-ordered responsibilities to decide whether the Reciprocals can be rehabilitated. If that access is not granted in the very near future, there is no way for the SDRs to obtain the information they need to make that decision responsibly. They therefore will have no choice but to liquidate the Reciprocals, thereby stranding, among others, thousands of Virginia professionals, leaving them without professional liability coverage.

It is true that the ROA/TRG Deputy Receiver and his staff are providing the Reciprocals with tens of thousands of pages of materials. But while the SDRs are appreciative of this help, it is not what was requested or is needed. There does not appear to be any priority to what is being provided (e.g., some of the materials provided are closed files, which, under the circumstances, are not of high priority to the SDRs), some information is inaccurate (e.g., some files that are indicated as being open are in fact closed), and some materials have not been provided at all (e.g., critical financial data).

The SDRs understand the difficulty the ROA/TRG Deputy Receiver and his staff appear to be having in addressing this complex receivership. Again, however, that is not the point. The SDRs merely have requested the opportunity to participate in the decision-making process – i.e., in the review of the books, records and other information under the control of ROA/TRG to determine what materials ROA/TRG in fact has, in the decision about the priority in which those materials are examined, and in the decision about which of the examined materials are those of the Reciprocals and which are the materials of ROA/TRG itself. The SDRs understand that mutually agreeable procedures will have to be developed to make this access meaningful to them and workable from the ROA/TRG Deputy Receiver's perspective. But this request repeatedly has been denied. States are accustomed to working together on complicated multi-state receiverships. In fact, in a recent multi-state receivership administered out of Tennessee, five states worked together on such issues as determining which materials were materials of receivers in which state and which materials would be shared by and accessible to all the receivers.

The ROA/TRG also has permitted interviews with personnel under the control of ROA/TRG, but only in the presence of one of the lawyers for ROA/TRG. Needless to say, this

is an intimidating atmosphere for the person being interviewed and one in which they can be unduly influenced in what they are willing to say.

1. The Circuit Court Order Purporting to Grant the ROA/TRG Receiver Exclusive Control Over Books, Records, Other Information and Personnel Apparently Was Procured without the Court Being Made Aware of the Interest of the Three Reciprocals in Those Materials and Personnel.

Based on the receivership Application and its ruling that ROA and TRG were a "single insurance business enterprise," and that TRG therefore was required to be placed into joint receivership with ROA, the Court proceeded to vest the Commission "with exclusive title both legal and equitable" to all property, including all of its assets, books, records, and other information, under the control of ROA/TRG. Richmond Circuit Court Order, Ex. 3, ¶ 8 at 8. The Court further empowered the Commission to "remove any and all records and other property … and to dispose of or destroy … such of those records and property that they may deem or determine to be unnecessary for the [ROA/TRG] receivership." Id., ¶ 7(j) at 7. In addition, the Court gave the Commission full authority over ROA/TRG personnel, see id., ¶¶ 10-11 at 9-10, which the ROA/TRG Deputy Receiver has interpreted to mean he may deny the SDRs and their staffs full, complete and unfettered access to those personnel, even to those who were responsible for the affairs of the three Reciprocals and ROA/TRG personnel who are or were officers or members of the Boards of Directors of one or more of the Reciprocals. See, e.g., Ex.33 at 4.[16]

It does not appear, however, that the Court was made aware of the inextricably intertwined relationship among ROA/TRG and the three Reciprocals prior to entry of its Order.

[16] See Confidential Endnotes.

The SDRs and the Reciprocals were not notified of the Richmond Circuit Court proceeding, were not parties to the proceeding, and were not referenced in the documents filed with the Court. There was no hearing on the Commission's Application.

Had ROA/TRG continued to manage claims asserted against the Reciprocals, which it no longer does, the Reciprocals clearly would be entitled to access to their books, records, and other information and to private discussions with their officers, directors, and key personnel – all of which, and all of whom, are or were provided by ROA/TRG and located at its offices in Richmond, Virginia, or elsewhere. The Court was not advised that the books, records and other information of the three Reciprocals were maintained by ROA/TRG and that key personnel managing their affairs also were provided by ROA/TRG.

The SDRs believe that, if the Richmond Circuit Court had been aware of these facts, it would not have entered its Order containing boilerplate provisions granting exclusive control to the ROA/TRG Deputy Receiver over all books, records, other information, and personnel under the control of ROA/TRG. Instead, the Court no doubt would have required the ROA/TRG Deputy Receiver and the three SDRs to develop an equitable process for determining which books, records and other information were the property of which estate and would have granted the three SDRs full, complete and unfettered access to ROA/TRG's current and former employees who were responsible for their affairs or who are or were officers of members of the Boards of Directors of one or more of the Reciprocals.

2. The Commission Should Modify the "Exclusive Control" Provisions of the Richmond Circuit Court Order to Recognize the Rights and Duties of the Tennessee SDRs Regarding the Reciprocals' Books, Records, Other Information and Personnel.

By exercising exclusive control over all the Reciprocals' books, records, and other information, and over all ROA/TRG personnel who are managing or managed the affairs of the Reciprocals, the ROA/TRG Deputy Receiver and his staff are acting in direct contravention of Tennessee law and the Tennessee Receivership Orders. That law and those Orders require that, in order to protect the interests of insureds, claimants, creditors and the public generally, the SDRs must fulfill certain fiduciary duties, including taking control of all assets, books, records, and other information of the Reciprocals and obtaining immediate access to all personnel responsible for the Reciprocals' affairs. Tennessee law and the Tennessee Receivership Orders also direct and order all persons who have access to those books, records, other information and personnel to cooperate with the SDRs. See Tenn. Code Ann. §§ 56-9-101(d), 56-9-106, 56-9-302, 56-9-303(d) (Exs. 40-41, 43-44); Tennessee Receivership Orders, Ex. 11-13, ¶¶ 1-4 at 2-5.

Section 56-9-106 of the Tennessee Code, for example, requires any "agent" or "person who exercises control directly or indirectly over activities of the insurer through any … affiliate of" an insurer in receivership "to cooperate" with the SDRs by "mak[ing] available to" the SDRs "any books, accounts, documents, or other records or information or property of, or pertaining to, the insurer and in such person's possession, custody or control." "No person shall obstruct or interfere with the … [SDRs] in the conduct of any delinquency proceeding or any investigation preliminary or incidental thereto." Tenn. Code Ann. § 56-9-106 (a)(1), (a)(2)(A), (a)(2)(B)(ii), (b) (Ex. 41). Any person who "willfully and wrongfully obstructs or interferes" with the SDRs in their conduct of the three Tennessee receiverships, or who violates any order of the Tennessee

Commissioner of Commerce and Insurance in the proceedings, may be fined by a court up to $10,000 or be found guilty of a felony, or be subject to a civil penalty imposed by the Commissioner of up to $10,000. Id. § 56-9-106(d).

The actions of the ROA/TRG Deputy Receiver and his staff are denying insureds of the Reciprocals critical protections afforded by Tennessee law for just this purpose. Sitting as a court of equity in these proceedings, however, see Va. Code §§ 38.2-1502 and 38.2-1508 (Michie Repl. Vol. 2002), the Commission can modify the terms of the Richmond Circuit Court Order regarding exclusive control of books, records, other information, and personnel to accommodate the requirements of Tennessee law and the Tennessee Receivership Orders.

Since the entry of the Richmond Circuit Court Order, and despite their ability and authority to do so, the ROA/TRG Deputy Receiver and his assistants have refused to take action to modify or seek modification of these provisions of the Order. To the contrary, they have attempted to capitalize on this Order, made in error without full disclosure of all the circumstances set forth above to the Richmond Circuit Court. They have asserted exclusive control and dominion over all of the Reciprocals' books, records, other information, and personnel under the control of ROA/TRG.

The ROA/TRG Deputy Receiver and his staff have been and are unilaterally reviewing the books, records and other information of which they are aware under the control of ROA/TRG, determining the order in which materials should be examined, sorting through those materials and determining, with no involvement of or collaboration with the Reciprocals, which ones they deem should be released to the SDRs. On information and belief, they have been and are retaining certain materials maintained in files relating to the Reciprocals without disclosure of the nature of the materials or the reasons for withholding them from the Reciprocals, and they

have been redacting certain documents (i.e., blocking out certain portions of those documents) prior to release to the Reciprocals. See letter from Commissioner Paula A. Flowers to ROA/TRG Deputy Receiver Alfred W. Gross, dated Feb. 21, 2003 (Ex. 16); reply letter from ROA/TRG Deputy Receiver Gross to Commissioner Flowers, dated Feb. 26, 2003 (Ex. 17); letter from J. Graham Matherne, Counsel to SDR for DIR, to Mark F. Bennett, Counsel to ROA/TRG Deputy Receiver Gross, dated Mar. 12, 2003 (Ex. 34); and reply letter from Mr. Bennett to Mr. Matherne, dated Mar. 26, 2003 (Ex.35). Moreover, they have not confirmed that they have not destroyed and will not destroy materials under the control of ROA/TRG relating to the Reciprocals as theoretically is permitted by the Richmond Circuit Court Order. See letter from J. Graham Matherne, Counsel to SDR for DIR, to Mark F. Bennett, Counsel to ROA/TRG Deputy Receiver Gross, dated Mar. 12, 2003 (Ex. 34); and reply letter from Mr. Bennett to Mr. Matherne, dated Mar. 26, 2003 (Ex. 35).

Such purported exclusive control is unfounded. It is contrary to the terms of the Tennessee law and the Tennessee Receivership Orders granting to the Receivers exclusive control of all Reciprocal-related property and personnel, and obligating the SDRs to discharge their fiduciary duties regarding the affairs of the Reciprocals. See Tenn. Code Ann. §§ 56-9-101(d), 56-9-106, 56-9-302 (Exs. 40-41, 43); Tennessee Receivership Orders, Exs. 11-13, ¶¶ 1-4 at 2-5.

The SDRs appointed by the Chancery Court of the State of Tennessee, like the ROA/TRG Deputy Receiver appointed by the Richmond Circuit Court, have mandated statutory and court-ordered fiduciary responsibilities for the orderly rehabilitation or liquidation of the Reciprocals' estates. To accomplish these mandates, the SDRs necessarily are obligated to obtain and review all of the books, records, and other information associated with the

Reciprocals. They are entitled to discuss matters with all officers, directors and key managers and other personnel associated with the Reciprocals' operations, and they are entitled to do so in private without the influence of, or potential intimidation by, the presence of others.

The inability of the Tennessee SDRs to have immediate, full, complete and unfettered access to books, records, other information, and key personnel (including some of their own officers and Boards of Directors members) is substantially and materially interfering with their ability to discharge properly their fiduciary duties. It also is interfering with their ability to understand fully the scope of the relationships of all the related entities, as well as to identify and secure the potential assets that may be available to pay claims against the Reciprocals and their insureds. The heavy-handed and obstructionist treatment shown to the SDRs should not be condoned by the Commission. The Richmond Circuit Court Order purporting to grant the ROA/TRG Deputy Receiver exclusive control over all books, records, other information, and personnel under the control of ROA/TRG should be modified by the Commission so that the SDRs may properly discharge their duties.

3. Applying the Commission's Own Criteria and the Law of the Case, TRG and Each of the Three Reciprocals Constituted a Separate "Single Insurance Business Enterprise."

There is an additional reason the Reciprocals are entitled to participate in the examination of all books, records and other information under the control of ROA/TRG to determine which ones are those of the Reciprocals, to take possession and control of those records, and to have access to current and former ROA/TRG personnel: TRG and each of the Reciprocals constituted a separate "single insurance business enterprise." Thus, each of the Reciprocals is entitled to access to books, records, other information, and personnel under the control of TRG.

a. The Commission Already Has Found That the "Single Insurance Business Enterprise" Concept Is Applicable to This Proceeding. It Therefore Is the "Law of the Case."

In its receivership Application to the Richmond Circuit Court, the Commission alleged, and the Court found, that ROA and TRG were operated as a "single insurance business enterprise" ("ROA/TRG"). See SCC Application, Ex. 21, ¶ 8 at 3; Richmond Circuit Court Order, Ex. 3, ¶ 2 at 3; accord First Directive, Ex. 1, ¶ 1 at 1; Third Directive, Ex. 2, ¶ 1 at 1. Much as courts have done in determining whether it was appropriate to "pierce the corporate veil," the Commission looked to factual realities rather than legal technicalities regarding the ROA/TRG relationship, noting the following:

> 18. ROA has entered into an exclusive management and insurance services agreement with TRG, pursuant to which TRG performs all of the actuarial, administrative, claims, premium collection, accounting, and records services for ROA for a fee.
>
> 19. TRG, in fact, executes, modifies and cancels the insurance agreements in the Reciprocal Program.
>
> 20. TRG collects premiums for ROA and is empowered to perform and function, and does in fact perform and function, for ROA in many other areas of insurance management.
>
> 21. In short, all of the traditional and expected functions that an insurer typically performs, with respect to ROA's reciprocal insurance contracts, are performed by TRG from TRG's principal offices at 4200 Innslake Drive, Glen Allen, Virginia, 23060
>
> 22. [ROA and TRG] … operate as an integrated operation designed to achieve the Single Insurance Business Enterprise, namely the maintenance of the Reciprocal Program.
>
> 23. The Single Insurance Business Enterprise is evidenced by the common offices shared by … [ROA and TRG], their centralized or consolidated accounting, the rendering of services by the employees of TRG on behalf of ROA, certain common directors or officers among TRG and ROA, the common

> administrative control of … [ROA and TRG], and the existence of substantial receivables among them.
>
> 24. As the Single Insurance Business Enterprise is managed, ROA cannot operate or function as a reciprocal without TRG's employees, facilities and services. …

SCC Application, Ex. 21, ¶¶ 18-24 at 4-5. The referenced criteria are virtually identical to criteria used by courts in other jurisdictions to determine whether two or more entities should be treated not as separate corporate entities, but as a "single business enterprise."[17]

Based on the Commission's representations and arguments, the Richmond Circuit Court held that ROA and TRG in fact operated as a "single insurance business enterprise" – ROA/TRG. See Richmond Circuit Court Order, Ex. 3, ¶ 2 at 2. In so doing, the Court made a legal ruling that entities may be treated as a single insurance business enterprise based on the referenced factors. That ruling became the "law of the case" for purposes of these receivership proceedings. See Harvey Constr. Co. v. Fairfax County Bd. of Supervisors, 31 Va. Cir. 177, 178 (Fairfax Cir. Ct. 1993) (ruling based on allegations in Motion for Judgment was thereafter "law of the case" to be applied in that case). As such, the Richmond Circuit Court's ruling is binding on the Commission, ROA, TRG and ROA/TRG.

b. TRG and Each of the Three Reciprocals Constituted a Separate "Single Insurance Business Enterprise."

In order to protect the rights of third persons and to prevent "affiliated corporations … [from] escap[ing] liability simply because of … business fragmentation," courts will view affiliated entities as a "single business enterprise" where the structure, finance and operations of

[17] See, e.g., Green v. Champion Ins. Co., 577 So.2d 249, 257-258 (La.App. 1st Cir. 1991), cert. denied, 580 So. 2d 668 (La. 1991) (listing 18 relevant factors to be considered in determining whether a "single business enterprise" exists); Glenn v. Wagner, 313 S.E.2d 832, 844 (N.C. App. 1984), rev'd on other grounds, 329 S.E.2d

affiliated entities demonstrate that the entities functioned as a single economic entity, despite internal compartmentalization of ownership and the existence of separate entities. Green v. Champion Ins. Co., 577 So.2d 249, 257-58 (La. App.), cert. denied, 580 So. 2d 668 (La. 1991).[18] In such situations, the doctrine of "separate legal entity" may not be properly raised to conceal the true relations of the entities. Green, 577 So.2d at 259. A review of the relationships between TRG and each of the Reciprocals, based upon even the limited information available to the SDRs at this time, clearly indicates each Reciprocal was a separate "single insurance business enterprise" with TRG – i.e., DIR/TRG, ANLIR/TRG, and TRA/TRG.[19]

As set forth in the SDRs verified Joint Petition, for example, ROA/TRG fostered, encouraged, supported, and promoted the creation and continued operation of each of the three Reciprocals.[20] ROA/TRG financed the very creation of DIR and ANLIR. ROA/TRG also was directly instrumental in bringing TRA, an existing risk retention group, into the fold. See Affidavit No.4, ¶ 6 at 2-3.[21]

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326 (N.C. 1985); Paramount Petroleum Corporation v. Taylor Rental Center, 712 S.W.2d 534, 536 (Tx. App. Ct. 14th Dist. 1986).

[18] See also Paramount Petroleum Corporation v. Taylor Rental Center, 712 S.W.2d 534, 536 (Tx. App. Ct. 14th Dist. 1986) (holding that where corporations are not operated as separate entities but rather integrate their resources to achieve a common business purpose, each constituent corporation is liable for debts incurred in pursuit of the business purpose).

[19] Indeed, it appears that ROA, TRG and all three Reciprocals also, collectively, constituted a larger "single business enterprise." See Part II D below. For purposes of deciding the right of the SDRs to immediate access to books, records, other information, and personnel under the control of ROA/TRG, however, it is not necessary for the Commission to determine that ROA, TRG and all three Reciprocals, collectively, constituted a larger single business enterprise. All that is required is a determination that TRG and each of the three Reciprocals constituted a separate single insurance business enterprise.

[20] See Confidential Endnotes.

[21] See Confidential Endnotes.

The allegations by the Commission with regard to the relationship between TRG and ROA, on which the Richmond Circuit relied in finding that ROA/TRG constituted a "single insurance business enterprise," apply equally to the relationship between TRG and each of the three Reciprocals as a separate "single insurance business enterprise." Indeed, the term "each Reciprocal" could easily be substituted for "ROA" in the Commission's allegations, and the allegations and findings still would be true:

> 18. [Each Reciprocal] … has entered into an exclusive management and insurance services agreement with TRG, pursuant to which TRG performs all of the actuarial, administrative, claims, premium collection, accounting, and records services for … [each Reciprocal] for a fee.
>
> 19. TRG, in fact, executes, modifies and cancels the insurance agreements in the Reciprocal Program .
>
> 20. TRG collects premiums for … [each Reciprocal] and is empowered to perform and function, and does in fact perform and function, for … [each Reciprocal] in many other areas of insurance management.
>
> 21. In short, all of the traditional and expected functions that an insurer typically performs, with respect to … [each Reciprocal's] reciprocal insurance contracts, are performed by TRG from TRG's principal offices at 4200 Innslake Drive, Glen Allen, Virginia, 23060
>
> 22. [TRG and each Reciprocal] … operate as an integrated operation designed to achieve the Single Insurance Business Enterprise, namely the maintenance of the Reciprocal Program.
>
> 23. The Single Insurance Business Enterprise is evidenced by the common offices shared by … [TRG and each Reciprocal], their centralized or consolidated accounting, the rendering of services by the employees of TRG on behalf of … [each Reciprocal], certain common directors or officers among TRG and … [each Reciprocal], the common administrative control of [TRG and each Reciprocal], and the existence of substantial receivables among them.

> 24. As the Single Insurance Business Enterprise is managed, … [each Reciprocal] cannot operate or function as a reciprocal without TRG's employees, facilities and services. …

SCC Application, Ex. 21, ¶¶ 18-24 at 4-5 (substituting "each Reciprocal" for "ROA"). Like ROA, each of the three Reciprocals entered into an exclusive management and insurance services agreement with TRG as attorney-in-fact for ROA. See Exs. 4A-C. Under these agreements, TRG performed all of the actuarial, administrative, claims, premium collection, accounting, and records services for each Reciprocal in return for fees. See Affidavit No.1, ¶¶ 5-7 at 2-3; Affidavit No. 4, ¶¶ 4-7 at 2-3.

Unlike typical reinsurance, ROA/TRG provided ANLIR and DIR with "first-dollar" claims coverage in which ANLIR and DIR retained none of the risk associated with the policies of their insureds. Since at least 1995, ROA/TRG also provided "first-dollar" claims coverage to TRA, subject to certain exceptions.[22] In all cases, each of the Reciprocals retained either no portion of the risk associated with the policies of its insureds, or at most a de minimis amount.[23] See Affidavit No.1, ¶¶ 12-14 at 5-6; Affidavit No.2, ¶ 9 at 4-5; Affidavit No.4, ¶ 10 at 4.

Moreover, certain officers and directors of TRG served in the same capacity for one or more of the three Reciprocals, some serving as officers for all three Reciprocals. See e.g., Ex. 6; Ex.20; Affidavit No.1, ¶ 10 at 4; Affidavit No.2, ¶¶ 4-5 at 2-3; Affidavit No. 3, ¶¶ 6-7 at 2;[24] Affidavit No.4, ¶¶ 7-8 at 3. Given this interlocking management scheme, there could be and were no genuine "arms-length" transactions between ROA/TRG and any of the Reciprocals. In

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[22] See Confidential Endnotes. "First dollar" coverage was not made available for all of TRA's policy types. Contractual arrangements between ROA/TRG and TRA called for 90% of the risk to be assumed by ROA/TRG in certain instances. See Ex. 9C.

[23] See Confidential Endnotes.

fact, the same signature routinely appears on agreements as the attorney-in-fact for each Reciprocal and for ROA. See Endorsements to Exs. 9A-C, 10.[25] It therefore appears that momentous decisions affecting the assets of each of the Reciprocals were made by common officers without prior approval or direction from the each Reciprocal's separate Boards of Directors. See Affidavit No.2, ¶¶ 11-12 at 5-6; Affidavit No.4, ¶¶ 9-10 at 4. Compare, e.g., Ex. 7, Ex. 8A and Ex. 8B.[26] Indeed, the separate Boards of the Reciprocals were not made aware of the dramatic changes affecting FVR and Gen Re reinsurance arrangements and trust fund reserves until some time after the effective date of the changes. See Exs. 8A-B .

Although each of the Reciprocals had an attorney-in-fact,[27] the functions of these attorneys-in-fact were delegated to TRG to perform. Affidavit No.1, ¶¶ 6-8 at 2-4, Aff. Ex. B; Affidavit No.2, ¶ 3 at 2; Affidavit No.4, ¶ 4 at 2. As such, there is no meaningful difference or effect attributable to the fact that TRG was ROA's attorney-in-fact in addition to the entity that managed all aspects of the insurance business and claims administration of each of the Reciprocals. Furthermore, as long as there were outstanding loans from TRG to the Reciprocals, the Reciprocals could not terminate their relationships with their attorneys-in-fact. See Ex. 38, ¶ art. III, sec.1(h) at 10-11;[28] Ex. 39, at 17;[29] Affidavit No.1, ¶¶ 6-8 at 2-4, and Aff. Exs. B and C.

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[24] See Confidential Endnotes.

[25] See Confidential Endnotes.

[26] See Confidential Endnotes.

[27] Federal law requires that risk retention groups, such as the Reciprocals, individually maintain an attorney-in-fact. See 15 U.S.C. § 3901. Additionally, "reciprocal insurance" is defined as "insurance resulting from the mutual exchange of insurance contracts among persons in an unincorporated association under a common name through an attorney-in-fact having authority to obligate each person both as insured and insurer." See Tenn. Code § 56-16-202(a)(2) (Ex. 42).

[28] See Confidential Endnotes.

In terms of structure, finance and operations, therefore, TRG and each of the Reciprocals functioned as a single, separate economic enterprise.[30] See Green, 577 So. 2d at 259. Thus, for the same reasons that the Commission alleged and the Richmond Circuit Court found that ROA/TRG constituted a single insurance business enterprise, TRG and each of the three Reciprocals also constituted a separate single insurance business enterprise.

Three other facts support this conclusion. First, in its management and insurance services agreement with each of the Reciprocals, TRG agreed to "establish and maintain for" each Reciprocal "all records required by law or by customary insurance and management practices…." See Exs. 4A, ¶ 2(i) at 4, 4B, ¶ 2.1(i) at 3, and 4C, ¶ 2(i) at 4.

Second, the reinsurance contracts between ROA/TRG and each of the Reciprocals provide that "[t]he Company [DIR, ANLIR or TRA] shall allow the Reinsurer [ROA/TRG] to inspect, at reasonable times, the records of … [DIR, ANLIR or TRA] relevant to the business reinsured under this Agreement, including … [DIR, ANLIR or TRA] files concerning claims, losses, or legal proceedings which involve or are likely to involve … [ROA/TRG]." See Exs. 9A and 9B, Art. XV at 12, 9C, Art. XV at 10. These provisions would be meaningless if ROA/TRG had primary ownership of the Reciprocals' books, records and other information, and a contract should not be interpreted so as to render one of its terms meaningless. Shepherd v. Davis, 265 Va. 108, 120, 574 S.E.2d 514**,** 520 (2003); Dominion Savings Bank, FSB v. Costello, 257 Va. 413, 417, 512 S.E.2d 564, 567 (1999).

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[29] See Confidential Endnotes.

[30] ROA/TRG and all three Reciprocals also operated, collectively, as a larger single economic enterprise. See Part II D below.

Third, in an April 4, 2003 filing with this Commission in response to a Joint Application for aid in their Tennessee receiverships submitted by the Reciprocals, the ROA/TRG Deputy Receiver conceded that "[r]ecords containing non-confidential information, in addition to being TRG records, are at the same time … records [of the Reciprocals] … ." See Response in Opposition to Joint Application for Order in Aid of Receiverships and Request for Expedited Review and Relief, at 6, in Commonwealth v. ROA et al., Case No. INS-2003-00066 (Va. State Corp. Comm'n, filed Apr. 4, 2003).

This separate "single insurance business enterprise" relationship with TRG entitles each Reciprocal to immediate, full and complete access to all books, records and other information under the control of ROA/TRG so that each Reciprocal may determine in which priority such materials should be examined, and of those examined, which in fact are those of each Reciprocal. This relationship also entitles each Reciprocal to immediate, full, complete and unfettered access to all current and former TRG personnel who were responsible for their affairs or who are or were their officers or directors.

II. THE INSUREDS OF THE THREE RECIPROCALS ARE ENTITLED TO BE TREATED IN THE SAME MANNER AND WITH THE SAME PRIORITY AS ROA/TRG POLICYHOLDERS.

A. BECAUSE ROA/TRG UNDERTOOK 100% OF THE CLAIMS RISK OF THE THREE RECIPROCALS AND CONTROLLED THEIR INSURANCE BUSINESS AND CLAIMS ADMINISTRATION, CLAIMANTS OF THE RECIPROCALS ARE ENTITLED TO "PIERCE THE REINSURANCE VEIL" AND HOLD ROA/TRG DIRECTLY ANSWERABLE AS A PRIMARY INSURER.

In an ordinary reinsurance arrangement, the reinsurer becomes liable for the "loss" by the primary insurer; it does not "insure" the risk. Thus, when the primary insurer is insolvent, the reinsurer in the ordinary reinsurance arrangement may not pay claims of particular insureds

because to do so would be to favor those insureds over other creditors of the primary insurer. Where, however, a "reinsurer" (here, ROA) undertakes 100% of the risk of the primary insurer (here, each of the three Reciprocals) and exercises control over the business and claims of that primary insurer, the "technical veil of reinsurance" will be "pierced" and the reinsurer (ROA) becomes directly responsible for the claims of insureds of the primary insurer when the primary insurer is insolvent. See Venetsanos v. Zucker, Facher & Zucker, 638 A.2d 1333 (N.J. Super. Ct. App. Div.), cert. denied, 644 A.2d 614 (N.J. 1994).[31] A leading authority states that:

> It has been held in various cases that the beneficiary of an insurance policy can recover directly against a reinsuring company if the policy issued by the latter to the first insurer is a promise to perform the duties of the original insurer created by the first insurance and is not merely an undertaking to indemnify or reimburse the first insurer.

9 Corbin on Contracts § 807 at 193 (1979) (citations omitted).

In Venetsanos, the so-called "reinsurer" in fact assumed 100% of the risks of the primary insurer, undertook the insurance investigations on claims against policies of the primary insurer, evaluated such claims, determined whether claims should be paid, negotiated and settled claims, directed the primary insurer to pay claims that the "reinsurer" determined should be paid, and then reimbursed the primary insurer for claims paid. Venetsanos, 638 A.2d at 1335-37. Given this arrangement, the court interpreted the "reinsurance" relationship in a manner that "avoid[ed] inequitable treatment of faultless insureds," and held the "reinsurer" directly answerable to the insured. Id. at 1339. Although recognizing that "[i]n a case involving a more orthodox

[31] See also Klockner Stadler Hurter Ltd. v. Insurance Co. of the State of Pa., 785 F. Supp 1130 (S.D.N.Y. 1990) (where reinsurer handled all insurance matters and dealt directly with the insured, the insured was permitted to sue the reinsurer directly); Allstate Ins. Co. v. Administratia Asigurarilor De Stat, 948 F. Supp. 285, 307-308 (S.D.N.Y. 1996) (where "the insured consistently deals directly with its insurer's reinsurer ... the reinsurer may become directly liable to the insured").

reinsurance situation, an insured would ordinarily be relegated to rights against the primary insurer," the Venetsanos court viewed the situation before it as "not an orthodox reinsurance matter." Id. at 1338.

Likewise, the relationship between ROA and the three Reciprocals also was not an "orthodox reinsurance matter." See Ex. 22. ROA/TRG created and funded two of the Reciprocals (DIR and ANLIR) as spin-offs to separate its malpractice business from its hospital and health systems liability and worker's compensation lines, and it created the third Reciprocal (TRA) for counselors and other healthcare professionals. See Affidavit No. 1, ¶ 11 at 5. But the three Reciprocals were "insurers" in name only.

So that ROA/TRG might continue to reap the benefit of the premiums from the Reciprocals, it had all Reciprocal premiums ceded to it and managed virtually every aspect of the relationships between it and the Reciprocals. See Affidavit No.1, ¶5 at 2; Affidavit No.2, ¶¶ 2-3 at 1-2; Affidavit No. 3, ¶¶ 7-9 at 2-3; Affidavit No.4, ¶¶ 5,7 at 2-3; Ex. 22; Exs. 4A-C. By contract with each Reciprocal, ROA/TRG incurred all the risk of the primary insurer and provided "first-dollar" claims coverage. All premiums were sent to ROA/TRG in Virginia. The Reciprocals had no employees of their own. See Affidavit No.2, ¶ 6 at 4; Affidavit No.3, ¶ 6 at 2. TRG, ROA's attorney-in-fact, managed and determined the claims from the Reciprocals' insureds, which were to be paid utilizing ROA's first-dollar coverage. Thus, ROA/TRG directly controlled the payment of all claims against the Reciprocals. See Affidavit No.1, ¶¶ 6-8 at 2-4; Affidavit No.2, ¶3 at 2; Affidavit No.4, ¶ 7 at 3.

The Supreme Court of Virginia has held that "[j]ust when a corporation will be regarded as the adjunct, creature, instrumentality, device, stooge, or dummy of another corporation is usually held to be a question of fact in each case." Lewis Trucking Corp. v. Commonwealth,

207 Va. 23, 31, 147 S.E.2d 747, 753 (1966) (quoting Beale v. Kappa Alpha Order, 192 Va. 382, 399, 64 S.E.2d 789 (1951)). The Lewis Court further held that "[w]here a corporation is so organized and controlled as to become the mere agent or instrumentality of another corporation, the courts have laid down the rule that the doctrine of corporate separateness may be ignored." Id. at 32, 174 S.E.2d at 753-754.

In the case at hand, the Reciprocals were adjuncts and instrumentalities of ROA/TRG. By exploiting such an arrangement, ROA/TRG stepped into the shoes of the Reciprocals as the primary "insurer." To avoid "inequitable treatment of faultless insureds," the Commission should "pierce the reinsurance veil" and hold that ROA/TRG is directly answerable to the Reciprocals' insureds.

In the alternative, to the extent the Commission finds that additional information is necessary to determine whether the "reinsurance veil" should be pierced, the SDRs respectfully request that, as requested in Part I A above, the Commission order the ROA Deputy Receiver and his staff to cease further dissipation of all assets under the control of ROA/TRG and stay any further payment of claims against ROA/TRG until this matter can be addressed on the merits.

B. AS A MATTER OF EQUITY, THE "REINSURANCE" AGREEMENTS BETWEEN ROA/TRG AND THE THREE RECIPROCALS MUST BE REFORMED BECAUSE THEY DID NOT INVOLVE ARM'S LENGTH TRANSACTIONS.

In these proceedings, the Commission functions as a court of equity. Va. Code §§ 38.2-1502, 38.2-1508 (Michie Repl. Vol. 2002). Sitting as a court of equity, the Commission may set aside contracts not made at arm's length to achieve a just result. The Supreme Court of Virginia long ago explained that:

> Equity grants relief wherever influence is acquired and abused, or confidence reposed and betrayed. Equity is especially jealous to

> guard the welfare of the weaker party in all contracts between parent and child, guardian and ward, attorney and client, trustee and cestui que trust, and, indeed, in all persons standing in fiduciary relations to each other. It is especially active and searching in dealing with gifts, voluntary conveyances and deeds without due consideration, though its range is so wide as to cover all possible dealings between persons holding such relations, or any relations in which dominion, whether physical, intellectual, moral, religious, domestic, or of any sort, may be exercised by one party over the other; or in which the parties contracting are not at arm's length.

Davis & ux. v. Strange's Executor, 86 Va. 793, 807, 11 S.E. 406, 411 (1890) (emphasis added, citations omitted).

Consistent with these equitable principles and in receivership proceedings such as these, contracts between parties may be reformed or set aside where they have not resulted from "arms-length" transactions. See Swiss Re Life Co. America v. Gross, 253 Va. 139, 146, 479 S.E.2d 857, 861 (1997) (denying equitable elevation of receivership priority under § 38.2-1509 where record reflected an arm's length transaction by reinsurer).

As between ROA/TRG and the Reciprocals, there were shared officers, directors and key personnel. See, e.g., Ex. 6;[32] Ex.20; Affidavit No.1, ¶¶ 15-16 at 7; Affidavit No.2, ¶¶ 4-5 at 2-3; Affidavit No.3, ¶¶ 6-7 at 2; Affidavit No.4, ¶ 8 at 3. Often the same persons signed significant documents regarding ceding of risk and premium dollars on behalf of most or all of the parties. See, e.g., Exs. 9 A-C and 10, and endorsements thereto. ROA/TRG was in fact managing all of the companies and was providing first-dollar coverage for the Reciprocals' insureds.

Under these circumstances, there could be — and were in fact — no genuine arm's length transactions between ROA/TRG and the Reciprocals. Thus, under principles of equity, the

[32] See Confidential Endnotes.

Commission should reform the contracts between ROA/TRG and each of the Reciprocals to recognize that the Reciprocals' insureds are "direct insureds" of ROA/TRG for purposes of treatment by and distributions from the ROA/TRG estate.

To the extent the Commission finds that additional information is necessary to determine whether arm's length transactions existed between ROA/TRG and any of the Reciprocals, the SDRs repectfully request that, as requested in Part I A above, the Commission order the stay of further dissipation of all assets under the control of, or available to, ROA/TRG and the payment of claims against ROA/TRG until this matter can be addressed on the merits.

C. ROA/TRG IS EQUITABLY ESTOPPED FROM DENYING ITS OBLIGATIONS TO THE RECIPROCALS AND THEIR INSUREDS.

"Equitable estoppel refers to the 'maxim that no man may take advantage of his own wrong.'" Chao v. Virginia Dept. of Transp., 157 F. Supp. 2d 681, 696 (E.D. Va. 2001) (quoting Glus v. Brooklyn E. Dist. Terminal, 359 U.S. 231, 232 (1959)). It has been described as:

> The effect of the voluntary conduct of a party whereby he is absolutely precluded, both at law and in equity, from asserting rights which might perhaps have otherwise existed, either of property, of contract, or of remedy, as against another person, who has in good faith relied upon such conduct, and has been led thereby to change his position for the worse, and who on his part acquires some corresponding right, either of property, of contract, or of remedy.

Chao, 157 F. Supp.2d at 696 (quoting Spencer W. Symons, 3 Pomeroy's Treatise on Equity Jurisprudence § 804 (5th ed. 1941)), aff'd in part, rev'd in part, 291 F.3d 276 (4th Cir. 2002).

The Supreme Court of Virginia has held that:

> To establish equitable estoppel, it is not necessary to show actual fraud, but only that the person to be estopped has misled another to his prejudice, Security Co. v. Juliano, Inc., 203 Va. 827, 834, 127 S.E.2d 348, 352 (1962), or that the innocent party acted in reliance

> upon the conduct or misstatement by the person to be estopped. Khoury v. Memorial Hospital, 203 Va. 236, 243, 123 S.E.2d 533, 538 (1962). Elements necessary to establish equitable estoppel, absent a showing of fraud and deception, are a representation, reliance, a change of position, and detriment. United States v. Fidelity and Casualty Co. of New York, 402 F.2d 893, 898 (4th Cir. 1968).

T v. T., 216 Va. 867, 872-873, 224 S.E.2d 148, 152 (1976) .

Under these principles of equity, ROA/TRG is estopped from disavowing that ROA/TRG has "first-dollar" coverage obligations flowing to the insureds of the three Reciprocals, who relied upon the promises of ROA/TRG that their claims would be paid in return for their premium payments. Such "first-dollar" coverage was to be backed by adequate trust fund reserves that turned out to be insufficiently funded. See Ex. 9A, art. XIII at 11; Ex. 9B, art. XIII at 11; Ex. 9C, art. XIII at 10; Ex. 22. Upon information and belief, ROA/TRG misled the Reciprocals and their insureds as to the financial wherewithal of ROA/TRG and its ability to fulfill its obligations. Affidavit No.1, ¶¶ 16, 20-22 at 7-9; Affidavit No.2, ¶¶ 9-11 at 4-6; Affidavit No.4, ¶¶ 9-10 at 4. Even as trust fund reserves were being inexplicably drained without replacement or were being used to pay its outstanding debts, ROA/TRG was aggressively advertising for new business, and insureds continued to enlist in or apply for insurance from the Reciprocals and pay premiums for insurance coverage, including "first-dollar" coverage that is not being, and may never be, afforded them. Reciprocal insureds relied on ROA/TRG's promises, paid premiums to have coverage as touted by ROA/TRG, and now are being advised that there are insufficient funds to pay claims against them – all to their significant financial detriment. Under these circumstances, ROA/TRG is equitably estopped from denying its obligations to insureds of any of the three Reciprocals.

D. THE THREE RECIPROCALS AND ROA/TRG CONSTITUTED A LARGER, COLLECTIVE "SINGLE INSURANCE BUSINESS ENTERPRISE" SUCH THAT RECIPROCAL CLAIMANTS ARE ENTITLED TO BE TREATED IN THE SAME MANNER AND WITH THE SAME PRIORITY AS CLAIMANTS UNDER ROA/TRG POLICIES.

As discussed previously, TRG and each of the three Reciprocals constituted a separate "single insurance business enterprise." In addition, and for the same reasons, ROA/TRG and all three Reciprocals constituted a larger "single insurance business enterprise" collectively. Just as "each Reciprocal" could be substituted for "ROA" in the Commission's receivership Application to the Richmond Circuit Court, "ROA and all three Reciprocals collectively" could be substituted for "ROA" and the allegations and findings still would be true. See SCC App., Ex. 21, at 4-5, ¶¶ 18-24 (substituting "ROA and all three Reciprocals collectively" for "ROA").

The Commission is required by the "law of the case" to apply the same criteria in evaluating the relationship between ROA/TRG and all three Reciprocals collectively as it did in evaluating the relationship between ROA and TRG. This collective relationship was virtually identical to, and therefore substantively the same as, the relationship between ROA and TRG. Accordingly, ROA/TRG and the three Reciprocals also constituted a larger "single insurance business enterprise."

Upon finding that a group of affiliated entities is in fact a "single business enterprise," the concept of corporate separateness may be disregarded to extend liability to each of the affiliated entities to prevent fraud or to achieve equity. Green, 577 So.2d at 259.[33] The rights of a

[33] See also Glenn v. Wagner, 313 S.E.2d 832, 844 (N.C. App. 1984), rev'd on other grounds, 329 S.E.2d 326 (N.C. 1985) ("The extension of liability for a corporations obligations beyond the confines of its own separate entity is appropriate in those cases where an essentially single business or economic enterprise is nevertheless conducted through several separate corporations… .")

claimant against one entity within the enterprise extend equally against another entity within the enterprise. Id.[34]

ROA/TRG was part of a single business enterprise with all three Reciprocals. As such, ROA/TRG should not be treated as a separate entity and mere "reinsurer" under the facts of this case. Instead, ROA/TRG should be deemed liable to claimants of each of the Reciprocals to the same extent the Reciprocals would be. To achieve equity, which the Commission is charged by statute to do, see Va. Code § 38.2-1508 (Michie Repl. Vol. 2002), insureds of the Reciprocals are entitled to be treated in the same manner and with the same priority as ROA/TRG insureds. Thus, all assets under the control of ROA/TRG must be made available in the same manner and with the same priority to satisfy claims of insureds and third-party claimants of the Reciprocals as they are to satisfy claims of ROA/TRG's direct insureds and third-party claimants.

To the extent the Commission finds that additional information is necessary to determine whether ROA/ TRG and the three Reciprocals constituted a larger "single insurance business enterprise," the SDRs respectfully request that, as requested in Part I A above, the Commission should order a stay of any further dissipation of assets under the control of ROA/TRG and the payment of any ROA/TRG claims until this matter can be addressed on the merits.

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[34] See also Glenn, 313 S.E. 2d at 848-849 (holding that it would be unconscionable to allow the owner of a single business enterprise to escape liability by transferring control to an operating company that "was simply itself in another form"), citing Luckenbach S.S. Co. v. W. R. Grace & Co., 267 Fed. 676 (4th Cir.), cert. denied, 254 U.S. 644 (1920); Joseph R. Foard Co. v. Maryland, ex rel. Goralski, 219 Fed. 827 (4th Cir. 1914); Schlamowitz v. Pinehurst, Inc., 229 F. Supp. 278 (M.D. N.C. 1964); Walkovszky v. Carlton, 18 N.Y. 2d 414, 276 N.Y.S.2d 585, 223 N.E.2d 6 (1966)); Paramount Petroleum Corporation v. Taylor Rental Center, 712 S.W.2d 534 (Tx. App. Ct. 14th Dist. 1986).

E. CLAIMS AGAINST THE THREE RECIPROCALS AND THEIR INSUREDS SHOULD BE CONSIDERED FOR PAYMENT AS "HARDSHIP" CLAIMS UNDER THE RICHMOND CIRCUIT COURT ORDER.

The Richmond Circuit Court gave the Commission and the ROA/TRG Deputy Receiver broad discretionary authority to exempt from the suspension of payment "those hardship claims, as he may define them, that he, in his sole discretion, deems proper under the circumstances." See Richmond Circuit Court Order, Ex. 3, ¶ 18(b) at 13. The claims of the three Reciprocals and their insureds qualify as hardship claims.

The current treatment of Reciprocal claimants as mere "creditors" with lower priority than ROA/TRG's direct insureds, and the corresponding refusal to consider claims against the Reciprocals and their insureds for payment unless and until the ROA/TRG Deputy Receiver believes there are sufficient funds to do so, is causing significant hardship to the Reciprocals' insureds. It is a very significant hardship — and a very high risk — for health professionals, lawyers, and other professional insureds to be exposed to the possibility that the professional liability insurance they had been promised does not exist. It affects their clients and patients, their businesses and practices, the public, and the insureds and their families personally. It also may interfere with licensing renewals, ongoing professional practices, and job opportunities. This is a "hardship" of enormous proportions. As a result, four of the major professional organizations representing insureds of the three Reciprocals have expressed their strong support for the Reciprocals' Notice of Appeal and Renewed Notice of Appeal to the ROA/TRG Deputy Receiver and for this Appeal. See Exs. 14, 15, 28, 29A-C, 30-32.[35]

[35] Letter from Hazle S. Konerding, M.D., President, The Medical Society of Virginia ("MSV"), to Commissioner Alfred W. Gross, Virginia Bureau of Insurance (Mar. 10, 2003) (Ex. 14); letter from Frank A. Thomas, III, President, The Virginia Bar Association ("VBA"), to Commissioner Alfred W. Gross, Virginia Bureau

The Commission has the discretion to pay hardship claims. On behalf of the insureds of the Reciprocals, the SDRs respectfully request that the Commission carefully consider whether all or some of the claims against the Reciprocals and their insureds should be paid as "hardship" claims under these unusual and very serious circumstances.

F. THE COMMISSION SHOULD EXERCISE ITS GENERAL DISCRETIONARY AUTHORITY GRANTED UNDER THE RICHMOND CIRCUIT COURT ORDER TO STAY ALL PAYMENTS TO ROA/TRG INSUREDS AND THIRD-PARTY CLAIMANTS UNTIL THIS MATTER CAN BE FULLY RESOLVED ON THE MERITS.

The Richmond Circuit Court Order authorizes the Commission to place a moratorium on payments due under subscriber agreements, policies, or contracts issued by ROA/TRG. Such a moratorium is discretionary, see Richmond Circuit Court Order Ex. 3, ¶ 18 at 12-13, and should be imposed by the Commission to stop payments to all ROA/TRG-related claimants until this matter is fully resolved on the merits.

Before ROA/TRG estate assets are depleted, thereby foreclosing any meaningful opportunity for claims against the three Reciprocals and their insureds to be paid from the ROA/TRG estate, the Commission should impose an immediate moratorium on the payment of any claims against ROA/TRG or any of its insureds until such time as the rights and obligations of all parties may be fully determined. Such a moratorium would not unduly impede the duties

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of Insurance (Mar. 11, 2003) (Ex. 15); letter from Hazle S. Konerding, M.D., President, MSV, to The Honorable Hullihen W. Moore, The Honorable Theodore V. Morrison, Jr., and the Honorable Clinton Miller, Virginia State Corporation Commission (Mar. 20, 2003) (Ex. 28); letters from Frank A. Thomas, III, President, VBA, to The Honorable Hullihen W. Moore, The Honorable Theodore V. Morrison, Jr., and The Honorable Clinton Miller, Virginia State Corporation Commission (Mar. 20, 2003) (Exs. 29A-C); letter from Isaac L. Wornom III, M.D., President, Richmond Academy of Medicine, Inc., to The Honorable Hullihen W. Moore, The Honorable Theodore V. Morrison, Jr., and The Honorable Clinton Miller, Virginia State Corporation Commission (Mar. 25, 2003) (Ex. 30); letter from Doris Rhea Coy, Ph.D., NCC, Chair, ACA Insurance Trust, Inc., to Commissioner Alfred W. Gross, Virginia Bureau of Insurance (Apr. 2, 2003) (Ex. 31); letter from David Kaplan, Ph.D., NCC, President, American Counseling Association, to Commissioner Alfred W. Gross, Virginia Bureau of Insurance (Apr. 4, 2003) (Ex. 32).

of the ROA/TRG Deputy Receiver. Rather, it would permit the receivers of all the parties to discharge their investigative and other statutory and court-ordered fiduciary duties to protect faultless insureds, thousands of whom are Virginians.

Such a moratorium also is in the interests of the citizens of Virginia. Those persons claiming to be affected by the alleged malpractice of Reciprocal insureds are much better protected by conservation of the ROA/TRG estate monies at this early juncture in these proceedings. The SDRs further submit that an immediate moratorium on payments to all ROA/TRG-related claimants also would protect those claimants from the risk and uncertainty that, if those payments ultimately are determined to be preferential payments, they would have to be disgorged and repaid to the ROA/TRG estate. Accordingly, the Commission should grant preliminary relief by exercising its general discretion under the Richmond Circuit Court Order to stop immediately the further dissipation of assets under the control of ROA/TRG until the matter can be fully resolved on the merits.

III. THE SDRs ALSO ARE ENTITLED TO THE RELIEF REQUESTED UNDER THE UNITED STATES CONSTITUTION AND THE CONSTITUION OF VIRGINIA.

A. THE TENNESSEE REHABILITATION ORDERS ARE ENTITLED TO BE GIVEN FULL FAITH AND CREDIT OR, UNDER VIRIGINA LAW, TO BE RECOGNIZED THROUGH COMITY.

1. In Critical Respects, the Tennessee Receivership Orders Are Entitled to Full Faith and Credit as a Constitutional Mandate.

The Tennessee Receivership Orders should be accorded full faith and credit and/or comity by the Commission, and recognized as orders of the Commission. Numerous courts across the country have held that the Full Faith and Credit Clause of the United States Constitution requires that foreign injunctive orders be enforced by the courts of sister states,

including Mississippi courts that have given full faith and credit to the Tennessee Receivership Orders.[36]

For purposes of full faith and credit, it is important to distinguish between the appointment of a receiver and the orders accompanying, and duties flowing from, that appointment – which is what is at issue here – and later actions of the receiver, such as proceedings in support of rehabilitation or liquidation. The appointment of a receiver is an in personam action, not an in rem action. "The appointment of a receiver is an equitable remedy. Equity acts in personam and not strictly in rem," and, therefore, "[t]he appointment of a receiver is predicated upon an equity suit in personam." 1 Ralph Ewing Clark, A Treatise on the Law and Practice of Receivers §§ 46, 47 and 282, at 48, 50 and 448 (3rd ed. 1959) ("Clark on Receivers"); see Va. Code §§ 38.2-1502, 38.2-1508 (Michie 2000 Repl. Vol.). The appointment of a receiver also implicates the property of the person placed in receivership, however. It therefore has been said that while the appointment of a receiver is not an in rem action, it is in the "nature" of a proceeding in rem: "An action in equity is a proceeding in personam, and the appointment of a receiver is, strictly speaking, a proceeding between parties although the appointment of a receiver has been termed a

[36] See, e.g., Order Granting Full Faith and Credit and Comity to Order of Rehabilitation and Injunction, in In Re: Paula A. Flowers, Commissioner of Commerce and Insurance for the State of Tennessee, in Her Official Capacity as Statutory Rehabilitator of American National Lawyers Insurance Reciprocal (Chancery Ct., 1st Judicial Dist., Hinds Cnty, Miss.) (Feb. 20, 2003) (Ex. 36A); Order Granting Full Faith and Credit and Comity to Order of Rehabilitation and Injunction, in In Re: Paula A. Flowers, Commissioner of Commerce and Insurance for the State of Tennessee, in Her Official Capacity as Statutory Rehabilitator of Doctors Insurance Reciprocal (Chancery Ct., 1st Judicial Dist., Hinds Cnty, Miss.) (Feb. 20, 2003) (Ex. 36B); Order Granting Full Faith and Credit and Comity to Order of Rehabilitation and Injunction, in In Re: Paula A. Flowers, Commissioner of Commerce and Insurance for the State of Tennessee, in Her Official Capacity as Statutory Rehabilitator of The Reciprocal Alliance (Chancery Ct., 1st Judicial Dist., Hinds Cnty, Miss.) (Feb. 20, 2003) (Ex. 36C); Underwriters Nat'l Assurance Co. v. North Carolina Life Acc. & Health Ass'n, 455 U.S. 691 (1982); Clark v. FitzGibbons, 105 F.3d 1049, 1052-53 (5th Cir. 1997); Superintendent of Insurance of the State of New York v. Baker & Hostetler, 668 F. Supp. 1057, 1059-61 (N.D. Ohio), aff'd, 826 F.2d 1065 (6th Cir. 1987); Bard, Commissioner of Banking and Insurance of the State of Vermont v. Charles R. Myers Ins. Agency, 839 S.W.2d 791, 794-95 (Tex. 1992).

proceeding in the nature of a proceeding in rem." 1 Clark on Receivers § 286, at 453 (emphasis added). The interaction has been described as follow:

> First. The court, in making the appointment, impliedly or expressly enjoins the parties to the suit, their agents and servants and if the defendant is a corporation, in addition its directors and officers from interfering with the receiver's possession and control of the property. …
>
> * * *
>
> Second. The court in appointing a receiver of the defendant's property, besides depriving the defendant of possession and control of the property, takes possession and control of the property itself acting through the receiver because the possession of the receiver is the possession of the court.
>
> How does the court take possession and control of the property? In the first place, … the court, acting in personam on the defendant, acts mediately or through the defendant on the defendant's property, and compels the defendant to give up his possession and control of the same.
>
> In the second place, a receivership is in the nature of a proceeding in rem. It is quasi in rem. The court, exercising the sovereign power of the state, acts constructively on all the property of the defendant, properly included in the court order, and within the court's territorial jurisdiction. The appointing order when placed in or on the court's records is constructive notice of the court's control and possession of the property.

1 Clark on Receivers § 47, at 50-51.

An in personam judgment properly entered by a court of competent jurisdiction in one state is constitutionally entitled to full faith and credit, including recognition and enforcement, by a sister state. See, e.g., Orchard Management Co. v. Soto, 250 Va. 343, 463 S.E.2d 839 (1995). "The Full Faith and Credit Clause of the Constitution of the United States requires that '[a] judgment entered in one State must be respected in another provided that the first State had jurisdiction over the parties and the subject matter." Id. at 350, 463 S.E.2d at 843 (citing

Bloodworth v. Ellis, 221 Va. 18, 21, 267 S.E.2d 96, 98 (1980) (quoting Nevada v. Hall, 440 U.S. 410, 421 (1979)). To the extent, therefore, that the Tennessee receivership court had in personam jurisdiction over each of the Reciprocals, orders of the Tennessee court are entitled to full faith and credit by the Commission and other Virginia courts.

Each of the Reciprocals was chartered in Tennessee and did business in Tennessee. Each also consented to the receivership, giving the Tennessee court another basis for in personam jurisdiction, and each also obviously had adequate notice of the receivership proceeding. See Tennessee Receivership Orders, Exs. 11-13. Thus, the Tennessee Chancery Court clearly had in personam jurisdiction over each of the Reciprocals. Once a court has in personam jurisdiction over a party, it may order the party to take certain actions involving property, even if that property is located outside the state. Such an order is enforceable against the party over which the court has proper jurisdiction (here, each of the Reciprocals) through the use of the court's contempt power, and it is entitled to full faith and credit in the state in which the property is located because the judgment was against the person, not against the property itself. See, e.g., Underwriters Assur. v. North Carolina Life, 455 U.S. 691 (holding in an Indiana insurer insolvency matter that where an Indiana rehabilitation court had jurisdiction over the subject matter and parties, full faith and credit must be afforded the court's order exercising jurisdiction over funds deposited in North Carolina as general assets of the insolvent insurer).

Each of the Tennessee Receivership Orders directed the SDRs to "take possession of the assets and records," ordered that the SDRs "shall have immediate access to and shall occupy and control the premises and all records, databases, and computer files used to carry out the business" of the three Reciprocals, and ordered that "all persons, firms, corporations and associations, including, but not limited to" the three Reciprocals and their "officers, directors,

stockholders, members, subscribers, agents, contractors, and all other persons with authority over or in charge of any segment of" each of the Reciprocals "affairs, are prohibited and temporarily enjoined from the transaction of … the business" of each of the Reciprocals "or the waste or disposition of its property, or the destruction, deletion, modification, or waste of its records, databases or computer files." Such persons also were ordered "to cooperate" with the SDRs, including "to preserve and to make available to" the SDRs "any and all books, bank and investment accounts, documents, or other records or information or computer programs and databases or property of or pertaining to" each of the Reciprocals and in such person's "possession, custody or control." Tennessee Receivership Orders, Exs. 11-13, ¶¶ 1-3 at 3-5.[37]

Since the Tennessee court clearly had in personam jurisdiction over each of the Reciprocals, it could order the Reciprocals, through the Tennessee Receiver and the SDRs, to take immediate possession and control of their books, records and other information, wherever located and to order their officers, directors, employees, other personnel and agents to cooperate with the SDRs. 3B Theodore Eisenberg, ed., Debtor-Creditor Law § 36.06[3][a][i] at 36-38 (2003). Since there was in personam jurisdiction over each of the three Reciprocals, these aspects of the Tennessee Receivership Orders are enforceable against each of the Reciprocals and are entitled to full faith and credit in Virginia. Either (1) TRG was in fact a "single insurance business enterprise" with all three of the Reciprocals or with each Reciprocal separately, in which case the books, records, other information, and personnel belong not merely

[37] See also Tenn. Code § 56-9-106(a)(1) (Ex. 41), requiring that "any…persons with authority over, or in charge of, any segment of the insurer's affairs, shall cooperate with the commissioner [the Tennessee Commissioner of Commerce and Insurance] in any proceeding under … [the receivership] chapter or any investigation preliminary to the proceeding." This provision further prohibits any person from obstructing or interfering with the Commissioner in the "conduct of any delinquency proceeding or any investigation preliminary or incidental thereto." Tenn. Code § 56-9-106(b) (Ex. 41).

to TRG, but also to the three separate single insurance business enterprises (DIR/TRG, ANLIR/TRG, and TRA/TRG) or to the one larger single insurance business enterprise comprised of TRG, ROA and all three Reciprocals; or (2) TRG was the "agent" of each of the Reciprocals, or a "contractor," or a person "with authority over or in charge of [each of the Reciprocal's] affairs," in which case TRG was holding the Reciprocals' books, records and other information, and TRG's employees were acting, on behalf of the Reciprocals. In either event, the Reciprocals are entitled to access to their books, records, and other information and to the ROA/TRG personnel who managed their businesses. See Regal Knitwear Co. v. NLRB, 324 U.S. 9, 13-14 (1945); 13 Moore's Federal Practice § 65.61[2] and [3] at 65-106 to 65-108 (3d ed. 2003).

In Regal, the U.S. Supreme Court explained that the federal rule which provides that an injunction is binding not only upon the parties to the case, but also upon their "officers, agents, … employees, … and upon those persons in active concert or participation with them who receive actual notice of the order by personal service as otherwise," was:

> derived from the common law doctrine that a decree of injunction not only binds the parties defendant but also those identified with them in interest, in "privity" with them, represented by them or subject to their control. In essence it is that defendants may not nullify a decree by carrying out prohibited acts [or refusing to carry out required acts] through aiders and abettors, although they were not parties to the original proceeding.

Regal, 324 U.S. at 13-14 (describing the basis for Federal Rule of Civil Procedure 65(d)).

By enforcing the Tennessee Receivership Orders in Virginia, the Commission is not enforcing those Orders against the property located in Virginia. It is enforcing the Orders against the person – each of the Reciprocals, and its officers, directors, employees, other personnel and agents – over which the Tennessee court had appropriate jurisdiction.

2. Comity

Even if a tribunal is not required to give a sister-state order full faith and credit, it still may recognize that order as a matter of "comity."[38] The Supreme Court of Virginia recently has described the "comity" principle as follows:

> Virginia courts should grant comity to any order of a foreign court of competent jurisdiction, entered in accordance with the procedural and substantive law prevailing in its judicatory domain, when that law, in terms of moral standards, societal values, personal rights, and public policy, is reasonably comparable to that of Virginia.

Oehl v. Oehl, 221 Va. 618, 623, 272 S.E.2d 441, 444 (1980). We have also stated:

> Comity is not a matter of obligation. It is a matter of favor or courtesy, based on justice and good will. It is permitted from mutual interest and convenience, from a sense of the inconvenience which would otherwise result, and from moral necessity to do justice in order that justice may be done in return. Comity is not given effect when to do so would prejudice a State's own rights or the rights of its citizens.

McFarland v. McFarland, 179 Va. 418, 430, 19 S.E.2d 77, 83 (1942) (internal quotation marks omitted).

> While fully appreciating the importance of comity as a guiding principle in the relationship between sovereigns and as a tool of judicial economy, we have recognized limitations upon its application. Before according the privilege of comity, we have required a showing of personal and subject matter jurisdiction, Oehl, 221 Va. at 623, 272 S.E.2d at 444, that "the procedural and substantive law applied by the foreign court [was] reasonably comparable to that of Virginia," id., that the decree was not

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[38] See, e.g., Isernam v. MBL Life Assurance Corp., 605 N.W.2d 215 (Wis. App. 1999); American Bonding Company v. Coastal Metal Sales, Inc., 679 So.2d 1250 (Fla. App. 1996); Frontier Insurance Company v. American Title Services, 2003 WESTLAW 131638 at *2 (Fla. App. 2003).

> "falsely or fraudulently obtained," McFarland, 179 Va. at 430, 19 S.E.2d at 83, that the order sought to be enforced was not "contrary to the morals or public policy of this State," id., and that the enforcement of the order would not "prejudice [Virginia's] own rights or the rights of its citizens," Eastern Indem. Co. v. Hirschler, Fleischer, Weinberg, Cox & Allen, 235 Va. 9, 15, 366 S.E.2d 53, 56 (1988) (citations omitted).

America Online, Inc. v. Anonymous Publicly Traded Co., 261 Va. 350, 360-61, 542 S.E.2d 377, 383 (2001). America Online involved an order from an Indiana court to an anonymous plaintiff permitting the litigant to try to obtain a subpoena ducus tecum from Virginia, under Virginia's version of the Uniform Foreign Depositions Act, requiring America Online ("AOL") to produce certain information about AOL subscribers. No hearing had been held in the Indiana court on proceeding anonymously, no evidence had been taken, and no reasons were given for the ex parte order permitting the plaintiff to proceed anonymously. Since the Court could not determine, among other things, whether the Indiana court had personal jurisdiction in the matter or whether Indiana's law was reasonably comparable to Virginia's, the Court refused to give comity to the Indiana court's order. Id. at 354-57, 361-62.

The three cases cited in America Online are instructive. In Oehl, a Virginia court granted a father who had deserted his wife certain visitation rights in the United States regarding their children. The mother took the children to England and, after presenting evidence to an English court that the children were suffering emotional distress over the fact that they might be required to leave their mother to live with their father in the United States, the English court ordered that any visitation by the father was required to take place in England. Finding that the English court had jurisdiction to order the change in custody, that English law was similar to Virginia's, and that the English court had found that the change in custody would be in the best interests of the

children, the Supreme Court of Virginia granted comity to the English order. Oehl, 221 Va. at 624-25, 272 S.E.2d at 444-45.

In McFarland, the Court decided not to grant comity to a North Carolina divorce decree that had been granted to a husband who had abandoned his wife for reasons that a Virginia court had found insufficient to justify the abandonment, that was inconsistent with a Virginia decree, and that "would inflict upon … [the spouse] a wrong as injurious as if that [North Carolina] decree had been fraudulently obtained." McFarland, 179 Va. at 430-32, 19 S.E.2d at 84.

In Eastern Indemnity, the Court discussed the application of comity to a proceeding involving an insurance receivership. Eastern Indemnity involved a Maryland receivership order granting a stay against "all claims, actions, and lawsuits" against the insolvent insurer. A Virginia law firm later sued in Virginia to collect fees from the insurer for services rendered. The Court first held that the Maryland order was not entitled to full faith and credit because the Maryland court had not had jurisdiction over the Virginia law firm when it issued the stay. Eastern Indemnity, 235 Va. at 13, 366 S.E.2d at 55. The Court then also held that it would not grant comity to the Maryland order because the insurer had been inconsistent in the way it had requested that comity be given to the Maryland order by not resisting the entry of several judgments in Virginia totaling over $400,000 but fighting the judgment of slightly over $40,000 in the case involving the law firm. Id. at 14-15, 366 S.E.2d at 55-56. The Court added, however:

> We have no reluctance whatsoever in saying that we would willingly show due deference to the orders of the Maryland court on any occasion when the circumstances are proper for the application of the principles of comity. We just do not think this is one of those occasions.

Id. at 14, 366 S.E.2d at 55.

The case at hand, of course, does not involve either the egregious circumstances present in McFarland or the inconsistencies present in Eastern Indemnity. Quite to the contrary, like Oehl, this clearly is a case where "the circumstances are proper for the application of the principles of comity," Eastern Indemnity, 235 Va. at 14, 366 S.E.2d at 55, and where there is "a sense of the inconvenience which would otherwise result" and a "moral necessity to do justice in order that justice may be done in return." McFarland, 179 Va. at 430, 19 S.E.2d at 83.

In the McCarran-Ferguson Act, Congress declared:

> that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

15 U.S.C. § 1011. See also 15 U.S.C. § 1012(a) ("[t]he business of insurance, and every person engaged therein, shall be subject to the laws of the several Sates which relate to the regulation or taxation of such business").[39] As a consequence, "[t]he states have primary responsibility for regulating the insurance industry." Barnhardt Marine Insurance, Inc. v. New England International Surety of America, Inc., 961 F.2d 529, 531 (5th Cir. 1992). See also Clark v. FitzGibbons, 105 F.3d 1049, 1051 (5th Cir. 1997); Lac D'Amiante du Quebec v. American Home Assur. Co., 864 F.2d 1033, 1039 (3rd Cir. 1988).

Because the primary regulation of the business of insurance has been relegated to the states, each state has enacted its own comprehensive scheme for the orderly supervision,

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[39] The McCarran-Ferguson Act was enacted in direct response to the decision by the U.S. Supreme Court in United States v. South-Eastern Underwriters Assn., 322 U.S. 533 (1944), in which the Court held that, where an insurance company conducted a substantial part of its business across state lines, it was engaged in interstate commerce and thereby was subject to federal antitrust laws. One year after the South-Eastern decision, Congress passed the McCarran-Ferguson Act, which affirmatively placed in the states the exclusive authority to regulate insurance.

rehabilitation, and/or liquidation of insolvent insurance companies. Indeed, such legislation – and concomitant interstate respect for state receivership proceedings – is critical to the protection of the insurance consumer because federal legislation specifically bars domestic and foreign insurance companies from the shelter of federal bankruptcy courts and the protections afforded by the automatic stay provisions of the federal Bankruptcy Code, which are applicable nationwide. See 11 U.S.C. §§ 109, 362. See generally Clark v. Williard, 292 U.S. 112, 127 (1934).

Tennessee is one of numerous states that has adopted the Model Liquidation Act. See State of Tenn., ex rel. Sizemore v. United Physicians Ins. Risk Retention Group, 56 S.W.3d 557, 562-63 (Tenn. App. 2001). As stated in Tennessee's version of the Act, such statutory schemes are essential for the "orderly, efficient, and expedient administration . . . of insolvent insurers [and for] the equitable apportionment of unavoidable loss." Tenn. Code § 56-9-101(d)(3)-(4) (Ex. 40). While Virginia has not adopted the Model Act, Virginia law governing receiverships of insolvent insurers is substantively similar to Tennessee's.

As recognized by the United States District Court for the Eastern District of Virginia, an insurer's rehabilitation proceeding under a state's statutory scheme:

> necessarily implicates the transfer or spreading of policyholders [sic] risk and is an integral part of the relationship between insurer and insured. To protect the important state interests involved, the Receivership Court has assumed in rem jurisdiction over the assets of [the insolvent insurer] and all claims thereto, staying legal proceedings against [the insurer] to allow the Receiver to formulate and implement a viable rehabilitation plan for the protection of [the company's] insureds. The creation by statute of a single, exclusive forum for insurance company rehabilitation proceedings is regulation of the "business of insurance" for purposes of the McCarran-Ferguson Act.

Eden Financial Group, Inc. v. Fidelity Bankers Life Ins. Co., 778 F. Supp. 278, 281 (E.D. Va. 1991).

Thus, the purpose of rehabilitation is to give a financially troubled insurer the opportunity to regain solid financial footing through the supervision and direction of the Receiver. Indeed, as stated by the Tennessee Court of Appeals, "rehabilitation is preferred over liquidation because of the public interest in insurance." State ex rel. Pope v. Xantus Healthplan of Tennessee, Inc., 2000 WESTLAW 630858 at *11 (Tenn. App. 2000). To this end, the Tennessee Insurers Rehabilitation and Liquidation Act grants to the Tennessee Commissioner of Commerce and Insurance "all the powers of the directors, officers, and managers" of the company and permits the Commissioner, as Receiver, the "full power to direct and manage . . . the property and business of the company." Tenn. Code § 56-9-303(c) (Ex. 44).

The exclusive nature of an insurance receivership extends not only to the affairs of the financially-troubled insurance company, but also to that company's assets — wherever such assets are located. Pursuant to the Tennessee Act, "[a]n order to rehabilitate the business of a domestic insurer . . . shall appoint the commissioner [as] the rehabilitator, and shall direct the rehabilitator forthwith to take possession of the assets of the insurer and to administer them under the general supervision of the court." Tenn. Code § 56-9-302(a)(1) (Ex. 43).

The Tennessee court clearly had jurisdiction over the three Reciprocals, and the Tennessee Receivership Orders were entered in accordance with that state's procedural and substantive law. The Tennessee receivership proceedings serve the interests of all persons and government entities concerned about creating an orderly process for liquidation or rehabilitation. The Tennessee process is substantively similar to the process in Virginia. Failure to accord the Tennessee Receivership Orders comity will be highly prejudicial to the thousands of Virginia

doctors, other healthcare professionals, counselors, and lawyers who are insured by the Reciprocals and whose interests are being served by the SDRs. For all of these important reasons, the Commission should give meaningful effect to the Tennessee Receivership Orders by recognizing those Orders through comity.

Furthermore, it is interesting to note that the ROA/TRG Deputy Director expects that the Richmond Circuit Court Order in this case and orders to be issued by the Commission or him in these ROA/TRG proceedings will be fully recognized and given effect in foreign jurisdictions. See, e.g., letter from Counsel for ROA/TRG Deputy Receiver Alfred W. Gross to the Greenville County, Superior Court (North Carolina), dated Mar. 26, 2003, at 3 (requesting that full faith and credit or comity be extended to the Richmond Circuit Court Order) (Ex. 37). Just as the ROA/TRG Deputy Receiver has sought, and presumably will continue to seek, comity (if not full faith and credit) for its orders in the ROA/TRG proceedings, the Tennessee Receivership Orders should be given full recognition and effect in Virginia at least through comity. This clearly is a case where there is a "moral necessity that justice be done in order that justice may be done in return." See McFarland, 179 Va. at 430, 19 S.E.2d at 83.

B. THE ROA/TRG DEPUTY RECEIVER IS IMPERMISSIBLY DISCRIMINATING AGAINST THE RECIPROCALS AND THEIR INSUREDS, THEREBY VIOLATING THEIR RIGHTS TO EQUAL PROTECTION UNDER THE UNITED STATES CONSTITUTION.

The Equal Protection Clause of the Fourteenth Amendment to the United States Constitution provides that no state shall "deny to any person within its jurisdiction the equal protection of the laws." U.S. Const. 14th amend. A state must treat similarly-situated persons alike, unless the state can articulate a legitimate state interest that is rationally related to any disparate treatment. See Personal Adm'r of Mass. v. Feeney, 442 U.S. 256, 271 (1979) (the

Equal Protection Clause "keeps governmental decision makers from treating differently persons who are in all relevant respects alike"); City of Cleburne v. Cleburne Living Ctr. Inc., 473 U.S. 432, 440 (1985) (holding that the Equal Protection Clause "is essentially direction that all persons similarly situated should be treated alike.").

1. The Deputy Receiver Impermissibly Discriminates by Refusing to Pay Claims Against the Reciprocals and Their Insureds.

The ROA/TRG Deputy Receiver's First Directive and his actions thereunder discriminate against the Reciprocals and their insureds. Pursuant to the First Directive, the ROA/TRG Deputy Receiver has taken the position that he will continue to administer and pay the claims of ROA/TRG's direct insureds and those of third-party claimants against ROA/TRG insureds, but that the insureds and third-party claimants of the Reciprocals must stand in line as general creditors of ROA/TRG.

Since all or virtually all of the premiums paid by insureds to the Reciprocals were passed on to ROA/TRG under the "reinsurance" arrangements, the immediate and unavoidable effect is that, whereas ROA/TRG has the means to continue to service its insureds, the Reciprocals cannot service their insureds in any meaningful way. The Reciprocals, for example, lack the funds to pay defense counsel or consummate settlement agreements. The ROA/TRG Deputy Receiver's actions have significantly and materially impaired the ability of the SDRs to rehabilitate the Reciprocals.

Each of the Reciprocals is related to TRG as a "single insurance business enterprise" in the same way ROA is related to TRG, and, as discussed above, ROA, TRG, and the three Reciprocals also constituted a larger "single insurance business enterprise." All are in receivership, and all are in need of rehabilitation, if possible. The insureds of the Reciprocals

bear the same relationship either to their separate or to the larger single insurance business enterprise as the insureds of ROA. All such insureds hold insurance policies with the single business enterprise and have legitimate expectations that the enterprise will continue to process claims, pay defense costs, and pay judgments or settlements as funds are available. The "first-dollar" insurance arrangement between ROA/TRG and the Reciprocals has blurred any distinction between the direct insureds of ROA/TRG and the insureds who were "reinsured" through the Reciprocals. The claims and positions of both groups of insureds are identical.

Finally, there is no "legitimate state interest" that is rationally related to this discriminatory practice. The ROA/TRG Deputy Receiver is charged with marshaling and distributing the assets of ROA/TRG in accordance with statutory priorities. The Tennessee SDRs have an identical charge under the Tennessee statutes and Tennessee Receivership Orders. The only conceivable rationale for the ROA/TRG Deputy Receiver's action is to ensure that ROA/TRG is rehabilitated with no participation by the Reciprocals, and in frustration of the statutory and court-order fiduciary duties of the Tennessee SDRs. This is not a legitimate state interest for purposes of the Equal Protection Clause.

"[T]he Equal Protection Clause forbids a State to discriminate in favor of its own residents solely by burdening 'the residents of other state members of our federation.'" Metropolitan Life Insurance Co. v. Ward, 470 U.S. 869, 878 (1985). To hold otherwise would essentially "eviscerate the Equal Protection Clause." Id. at 882. Like the state action in Metropolitan Life, the actions of the ROA/TRG Deputy Receiver are clearly designed for no other purpose than to favor domestic Virginia companies (ROA and TRG) by burdening the three Tennessee-domiciled Reciprocals.

It is immaterial that the insureds of the Reciprocals are, in form only, "reinsureds" of ROA/TRG, rather than direct insureds of ROA/TRG. Ordinarily a state receivership has a legitimate reason for treating direct insureds differently from reinsureds in the payment of claims. Receivership statutes authorize such differential treatment of insureds and reinsureds, however, only where the reinsurance arrangement is at arm's length and the primary risk remains with the initial insurer, neither of which is the case here. The "fronting" arrangement between ROA/TRG and the three Reciprocals and the "single insurance business enterprise relationship" among all five companies, coupled with the "first-dollar" insurance relationship between ROA/TRG and the Reciprocals demonstrates that there is no legitimate reason for treating ROATRG and the three Reciprocals, or their insureds, differently from one another in the payment of claims.

2. The Deputy Receiver Impermissibly Discriminates by Refusing the Reciprocals Full and Complete Access To Books, Records, Other Information and Employees.

For the same reasons, the ROA/TRG Deputy Receiver impermissibly discriminates against the Reciprocals and their insureds by refusing the SDRs full, complete and unfettered access to all books, records and other information of their respective companies that are under the control of ROA/TRG, and to current and former personnel of ROA/TRG. Access to books, records, information, and personnel is essential to the successful administration of a company in receivership and to eventual rehabilitation. The ROA/TRG Deputy Receiver has publicly and repeatedly expressed his intention to rehabilitate ROA/TRG. At the same time, however, by limiting the Reciprocals' access to books, records, information and personnel, the ROA/TRG Deputy Receiver has significantly and materially impaired the ability of the SDRs to rehabilitate the Reciprocals. The SDRs should be given the same opportunity to rehabilitate the Reciprocals

as the ROA/TRG Deputy Receiver has had to rehabilitate ROA/TRG, especially when the economic lives and professional careers of thousands of professionals in Virginia and elsewhere are at stake.

ROA/TRG and the Reciprocals are similarly situated. All are in rehabilitation. The receivers for all four insurers have the same statutory duties to marshal assets, maintain and utilize books, records, and other information, and administer and process claims according to statutory priorities. All were part of a single insurance business enterprise with ROA and TRG, or were a separate single business enterprise with TRG, before the receivership orders were entered. There is no legitimate state interest in denying the SDRs full and complete access to the books, records, other information, and current and former personnel under the control of ROA/TRG. Metropolitan Life, 470 U.S. at 869. Equal protection guarantees demand that the SDRs be given full, complete and unfettered access to those books, records, other information and personnel.

C. THE ACTIONS OF THE ROAG/TRA RECEIVER VIOLATE THE DUE PROCESS RIGHTS OF THE RECIPROCALS AND THEIR INSUREDS.

The Due Process Clauses of the United States Constitution and the Constitution of Virginia provide that no person shall be deprived of life, liberty, or property without due process of law. U.S. Const. amend. XIV, § 1; Va. Const. art. I, § 11. The ROA/TRG Deputy Receiver's First and Third Directives take the property of the Reciprocals and their insureds without due process of law.

"The requirements of Due Process are satisfied if [state actions] have reasonable relation to a proper purpose and are neither arbitrary nor discriminatory." King v. Virginia Birth-Related Neurological Injury Comp. Program, 242 Va. 404, 412, 410 S.E.2d 636, 661 (1991) (quoting

Duke v. County of Pulaski, 219 Va. 428, 437-38, 247 S.E.2d 824, 829 (1978)); Etheridge v. Medical Center Hosp., 237 Va. 87, 98, 376 S.E.2d 525, 530 (1989). A state action can survive a due process challenge only if it is rationally related to a legitimate state interest. King, 242 Va. at 412, 410 S.E.2d at 661 (citing Weinberger v. Salfi, 422 U.S. 749, 771-71 (1975) and Etheridge, 237 Va. at 98, 376 S.E.2d at 530).

1. The Actions of the ROA/TRG Deputy Receiver Violate Due Process Guarantees Because They Are Not Rationally Related to Any Legitimate State Interest.

Virtually all of the risk and the premiums paid by insureds of the Reciprocals were transferred to ROA/TRG under "first-dollar" "reinsurance" arrangements. The Reciprocals and their insureds have a property interest in these premium funds, which were intended to cover claims under the insurance policies issued by the Reciprocals. Indeed, because of the "fronting" arrangement between ROA/TRG and the Reciprocals, the lack of arm's length transactions between ROA/TRG and the Reciprocals, the facts giving rise to equitable estoppel, and the fact that ROA/TRG operated as a single insurance business enterprise with the Reciprocals, as discussed in Parts II A-D above, the Reciprocals and their insureds have a property interest in all of the assets under the control of ROA/TRG. Yet, the ROA/TRG Deputy Receiver's First Directive clearly permits, and his actions pursuant to that Directive clearly have resulted in, the depletion of these assets by paying claims against ROA/TRG and its direct insureds.

There is no legitimate state interest that is rationally related to this deprivation of property rights. The ROA/TRG Deputy Receiver's apparent motivation – to protect the estate of ROA/TRG at the expense of the estates of the Reciprocals – is not a legitimate state interest. Under the facts of this case, therefore, the ROA/TRG Deputy Receiver's decision to pay claims

of "direct" insureds but not claims pursuant to its "reinsurance" obligations clearly is a violation of due process.

2. The ROA/TRG Deputy Receiver's Third Directive Denies Due Process Because It Does Not Provide an Adequate and Impartial Procedure for Challenging His Decisions or Those of His Staff.

Due process also guarantees a person the right to reasonable notice and a meaningful opportunity to be heard. Etheridge v. Medical Center Hosp., 237 Va. 87, 98, 376 S.E.2d 525, 530 (1989) (citing Parratt v. Taylor, 451 U.S. 527 (1981)). This due process guarantee provides procedural safeguards against the arbitrary deprivation of constitutionally protected interests, including interests in property. Etheridge, 237 Va. at 87, 376 S.E. 2d at 530 (citing Leis v. Flynt, 439 U.S. 438, 441 (1979)). The particular procedures required will depend on the affected interest or potential deprivation. Kentucky Central Life Insurance Co. v. Stephens, 897 S.W.2d 583, 590 (Ky. 1995) (citations omitted). But there must be a meaningful opportunity to present one's case at a meaningful time.

In Mathews v. Eldridge, 424 U.S. 319 (1976), the U. S. Supreme Court set forth three factors to consider in determining whether the procedure afforded is constitutionally adequate:

1. The private interest that will be affected by the government's action;
2. The risk of erroneous deprivation of that interest through the procedures used and the probable value, if any, of additional procedures; and
3. The government's interest, including the function involved and the fiscal and administrative burdens that the additional procedural requirement would entail.

Id. at 335.

The ROA/TRG Deputy Receiver's Third Directive adopts an announced "exclusive" appeal procedure for "appeals and challenges of any decision made by the ROA/TRG Deputy

Receiver or Special Deputy Receiver regarding non-Insurance Policy Claims." Under this announced "exclusive" route to the Commission, any Notice of Appeal must:

- include "all supporting documents and a full and detailed explanation";
- include all bases for appeal in order not to waive them; and
- include in any later appeal to the Commission only grounds or bases for appeal that were presented in the preceding appeal to the Deputy Receiver.

See Third Directive, Ex. 2, ¶¶ 3-5 at 4-5. The ROA/TRG Deputy Receiver has 30 days to rule on a Notice of Appeal and issue a Determination of Appeal. However, "the Deputy Receiver [also] may extend the time by which he must determine an appeal by up to ninety (90) additional days by sending a written Extension of Appeal" to the appellant – or a total of 120 days or four months from the initial appeal to the ROA/TRG Deputy Receiver. Id. ¶ 8 at 6.

As to the Reciprocals, this "exclusive" appeal procedure violates procedural due process in at least three respects. First, the Reciprocals must appeal initially to the ROA/TRG Deputy Receiver, who in his First Directive already has made the decision that the Reciprocals and their insureds are "creditors" and not "policyholders" of ROA/TRG. Under the circumstances, an "appeal" of this determination to the ROA/TRG Deputy Receiver is fruitless, since he cannot provide an unbiased review of his own decision, particularly in light of his own duties to ROA/TRG. Thus, there is no meaningful opportunity for the Reciprocals to be heard by the ROA/TRG Deputy Receiver on this issue.

Second, the continued refusal of the ROA/TRG Deputy Receiver to provide to the SDRs full, complete and unfettered access to books, records, other information and personnel under the control of ROA/TRG prevents the Reciprocals from access to much of the very information required by the Third Directive to support their appeal. There simply is no meaningful

opportunity for an appeal because the Reciprocals have no meaningful access to information that would allow them to present fully developed arguments or the necessary factual basis for those arguments.

Third, the appeal procedures established by the Third Directive provide no mechanism for avoiding irreparable harm by means of an expedited appeal. The ROA/TRG Deputy Receiver may take up to 120 days/four months to decide the Reciprocals' appeal. In this case, the Reciprocals first requested expedited consideration and an expedited decision in their February 28, 2003 Notice of Appeal. They renewed that request for expedited relief in their March 14, 2003 Renewed Notice of Appeal. On March 24, 2003, counsel informed the Reciprocals that the ROA/TRG Deputy Receiver was extending the deadline for his decision until June 18, 2003 — or a 72-day extension of the deadline and 110 days after the Reciprocals first requested expedited relief. In the meantime, pursuant to the First Directive, the claims of ROA/TRG insureds and third-party claimants continue to be paid. Thus, assets to which the Reciprocals believe their insureds also are entitled may well be dissipated before any decision is made on the appeal. In addition, the ROA/TRG Deputy Receiver has repeatedly rejected requests by the SDRs to access to the Reciprocals' books, records and other information and to the personnel who serviced the Reciprocals.

In short, the Reciprocals and their insureds have a legitimate interest in the assets under the control of ROA/TRG, yet they have been afforded no meaningful or effective opportunity by the appeal procedures established by the ROA/TRG Deputy Receiver's Third Directive to minimize the risk of erroneous deprivation of their property interest in those assets.

D. THE ACTIONS OF THE ROA/TRG DEPUTY RECIEVER PLACE AN UNCONSTITUTIONAL BURDEN ON INTERSTATE COMMERCE.

The ROA/TRG Deputy Receiver's First Directive has the purpose and/or effect of impermissibly discriminating against or burdening interstate commerce, a result which is prohibited by the Commerce Clause of the United States Constitution. U.S. Const. Art. I, § 8, Cl. 3. The Commerce Clause prohibits states from enacting legislation which discriminates on its face against interstate commerce. See, e.g., Hughes v. Oklahoma, 441 U.S. 322, 326 and n. 2 (1979). The Commerce Clause also prohibits states from taking action which, although not based on facially discriminatory legislation, directly regulates interstate commerce by projecting the reach of state law or agency action beyond the boundaries of the state. Brown-Forman Distillers Corp. v. New York State Liquor Authority, 476 U.S. 573 (1986) (New York law invalidated because it "projected its legislation into [other states] by regulating the price to be paid" for liquor in those states); see also, Healy v. Beer Institute, 491 U.S. 324 (1989) (Commerce Clause protects against "the projection of one state's regulatory regime into the jurisdiction of another state"). Id., at 337; Edgar v. MITE Corp., 457 U.S. 624, 641 (1982) (Illinois corporate anti-takeover statute offended the Commerce Clause because it "directly regulates transactions which take place across state lines, even if wholly outside the State of Illinois"). The projection of extraterritorial "practical effect[s]," even if unintended, exceed the states' powers under the Commerce Clause. Id., at 642-43. Where the practical effect of state action is to directly regulate interstate commerce by projecting its regulatory schemes into other states, there is a virtual per se rule of invalidity under applicable principles of dormant Commerce Clause jurisprudence. Waste Management Holdings, Inc. v. Gilmore, 252 F.3d 316, 333 (4th Cir. 2001).

The ROA/TRG Deputy Receiver is constituted as a Virginia state official pursuant to the Richmond Circuit Court Order. See Richmond Circuit Court Order, Ex. 3, ¶ 19 at 13-14. His actions undertaken while acting in his official capacity are thus state action for purposes of Commerce Clause analysis. There can be no doubt that the practical effect of the ROA/TRG Deputy Receiver's actions is to obstruct and interfere with the lawful actions of the SDRs undertaken in their efforts to rehabilitate the Reciprocals, which are Tennessee-domiciled companies. The Orders of the Tennessee receivership court establish the SDRs as managers controlling the business affairs of the Reciprocals. In their capacity as SDRs, they must tend to all aspects of attempting to continue the business of the Reciprocals, gather records, marshal assets, negotiate with claimants, recover property and otherwise generally conduct either the rehabilitation of the Reciprocals in a business-like fashion or the liquidation of the Reciprocals' affairs. See Tennessee Receivership Orders, Exs. 11-13. While the SDRs act in an official capacity pursuant to the order of the Tennessee receivership court, they also act as business managers in an effort to conduct the delicate business affairs of troubled companies whose mission is to protect the interests of policyholders to the maximum extent. Id. Accordingly, the SDRs are engaged in commerce. The interests of the Reciprocals are spread over a number of states in which the Reciprocals do or did business. Thus, the business in which the Reciprocals' receiverships are engaged is in interstate commerce.

The ROA/TRG Deputy Receiver has wrongfully obstructed, impeded and interfered with the conduct of the Tennessee receiverships. The apparent motive is to garner for the ROA/TRG receivership more assets and fewer liabilities with which to conduct business. The ROA/TRG Deputy Receiver has blocked the SDRs' efforts to obtain unfettered access to the records of their companies. See, e.g., Exs. 16, 17, 34, 35. The ROA Deputy Receiver has even resorted to

blocking the SDRs' attempts to interview and work with the ROA/TRG employees who managed the Reciprocals' affairs and who, in effect, are the employees of the SDRs' companies.

The McCarran-Ferguson Act, 15 U.S.C.A. § 1012,[40] does not shield the activities of the ROA/TRG Deputy Receiver from the reach of the Commerce Clause. While the McCarran-Ferguson Act has been broadly interpreted as "exempting" the insurance industry from Commerce Clause restrictions, the U.S. Supreme Court has noted, that in enacting the legislation in response to United States v. South-Eastern Underwriters Assn., 322 U.S. 533 (1944), "… Congress did not intend thereby to give the States any power to tax or regulate the insurance industry other than what they had previously possessed." Metropolitan Life, 470 U.S. at 880 and n8 (citing Western and Southern Life Ins. Co. v. State Board of Equalization of California, 451 U.S. 648, 656 and n.6 (1981)). The McCarran-Ferguson Act does immunize state insurance regulators when they are engaged in the regulation and taxation of the business of insurance.[41] Moreover, the normal conduct of a receivership for an insolvent or financially troubled insurer

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[40] 15 U.S.C. § 1012 provides, in relevant part:

> (a) State regulation
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> The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.
>
> (b) Federal regulation
>
> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance … .

[41] In determining whether a particular activity constitutes "the business of insurance," the U.S. Supreme Court articulated three factors to be considered: "first, whether the practice has the effect of transferring or spreading a policyholder's risk; second, whether the practice is an integral part of the policy relationship between the insurer and the insured; and third, whether the practice is limited to entities within the insurance industry." Union Labor Life Ins. Co. v. Pireno, 458 U.S., 119, 129 (1982) (emphasis in original), accord, Ambrose v. Blue Cross Blue Shield of Virginia, Inc, 891 F. Supp. 1153, 1158 and nn.4, 5. (E.D. Va., 1995).

has been held to constitute the "business of insurance" for purposes of the McCarran-Ferguson Act. See Department of Treasury v. Fabe, 508 U.S. 491, 508 (1993).

Nothing in the McCarran-Ferguson Act, however, purports to authorize one state-created receivership to interfere with or obstruct the "business of insurance" occurring in another state under the guise of a second state-created receivership. Federal courts ordinarily will not construe federal legislation such as the McCarran-Ferguson Act to have authorized states to discriminate against or burden interstate commerce in the absence of express terms so stating. See e.g., Wyoming v. Oklahoma, 502 U.S. 437, 458 (1992) ("Congress must manifest its unambiguous intent before a federal statute will be read to permit or approve…a violation of the [dormant] Commerce Clause…"); Maine v. Taylor, 477 U.S. 131, 138-39 (1986) ("because of the important role the Commerce Clause plays in protecting the free flow of interstate trade, this Court has exempted state statutes from the implied limitations of the Clause only when the congressional direction to do so has been unmistakably clear") (internal quotation marks and citations omitted); South Central Timber Dev., Inc. v. Wunnicke, 467 U.S. 82, 91 (1984) ("[F]or a state regulation to be removed from the reach of the dormant Commerce Clause, congressional intent must be unmistakably clear."); Waste Management Holdings, Inc. v. Gilmore, 252 F.3d 316, 346 (4th Cir. 2001) ("congressional intent…must be either unmistakably clear or expressly stated'). Nothing in the McCarran-Ferguson Act grants the Commonwealth of Virginia or the ROA/TRG Deputy Receiver the authority to burden the business affairs of another state's lawfully-established receivership.

CONCLUSION

For the foregoing reasons, the SDRs and the Reciprocals for which they were appointed should be granted the relief requested in their Petition in all respects.

Respectfully submitted,

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